

February 2009

Broker-Dealer Alert



FINRA Seeks to Harmonize Financial Responsibility and Operational Rules

The Financial Industry Regulatory Authority (“FINRA”) recently released Regulatory Notice 09-03 (“Notice”), which contains a proposal for a single set of financial responsibility and related operational rules for the Consolidated FINRA Rulebook.¹ As summarized below, the proposed rules are not expected to impact significantly those firms operating today under the Incorporated New York Stock Exchange (“NYSE”) rules. For the non-NYSE firms, however, the Notice includes a number of proposed changes that would add to their existing regulatory requirements under the National Association of Securities Dealers (“NASD”) rules. The comment period for the proposed rules expires **February 20, 2009**.

As currently proposed, FINRA Rule 4150 would require that prior written notice be given to FINRA whenever a member firm guarantees, endorses or assumes the obligations or liabilities of another person or receives flow-through capital benefits in accordance with Appendix C of the Securities Exchange Act of 1934 (“SEA”) Rule 15c3-1; Rule 4311 would set forth the requirements applicable to member firms when entering into agreements for the carrying of customer accounts; Rule 4522 would impose certain requirements relating to periodic security counts, verifications and comparisons; and Rule 4523 would ensure the accuracy of each member firm’s books and records and include supervisory measures for their implementation.

The table below summarizes these proposed rules and, where applicable, references the current NASD or Incorporated NYSE rule upon which the proposed rule is based.²

Specific Provisions of the Proposed FINRA Rule	Corresponding NASD Rule	Corresponding Incorporated NYSE Rule
4150 -Guarantees by, or Flow Through Benefits for, Members		

¹ The Notice is available at <http://www.finra.org/Industry/Regulation/Notices/2009/P117680>. The proposed rules discussed in the Notice would supplement the recent rule filing made by FINRA, SR-FINRA-2008-067 (Proposed Rule Change to Adopt Rules Governing Financial Responsibility in the Consolidated FINRA Rulebook), which was filed with the SEC on December 29, 2008. For information about this rule filing, see FINRA Regulatory Notice 08-23 (May 2008).

² The proposed rules would replace NYSE Rules 322 (Guarantees by, or Flow Through Benefits for Members or Member Organizations), 382 (Carrying Agreements) (including Rule 382’s Interpretations), 440.10 (Periodic Security Counts, Verifications, Comparisons, etc.) and 440.20 (Identification of Suspense Accounts and Assignment of Responsibility for General Ledger Accounts), and NASD Rule 3230 (Clearing Agreements).

Rule 4150.01 describes the timing and details of what constitutes the notice.	N/A	NYSE Rule Interpretation 322.10
Rule 4150.02 provides that a member firm may at any time (<i>i.e.</i> , not just within the context of the prior written notice the member firm provides pursuant to the proposed rule) be required to provide FINRA with information with respect to the arrangement, relationship and dealings with a person referred to in the proposed rule.	N/A	NYSE Rule Interpretation 322.11
Rule 4150.03 prohibits any member firm from entering into an arrangement described in the proposed rule unless the firm has the authority to make available promptly the books and records of the other person for inspection by FINRA in the United States. Further, the proposed rule provides that the books and records of the other person must be kept separately from those of the member firm.	N/A	NYSE Rule Interpretation 322.12
Rule 4150.04 requires, with respect to registered broker-dealers, that the member firm must furnish to FINRA copies of the persons' FOCUS Reports simultaneous with their being filed with the persons' designated examining authority. With respect to persons who are not registered broker-dealers, the proposed rule requires, in lieu of FOCUS Reports, submission of financial and operational statements, in such format and at such time periods as FINRA may require, sufficient to gauge the capital and operational effects of the arrangement or relationship on the member firm.	N/A	NYSE Rule Interpretation 322.13
Rule 4150.05 provides that guarantees executed routinely in the normal course of business, such as trade guarantees, signature guarantees, endorsement of securities and the writing of options, are not subject to the requirements of the proposed rule provided that, in regard to the guarantee of the writing of options, the transaction is appropriately recorded on the member firm's books and records in accordance with SEA Rule 17a-3(a) (10) and is reflected in its capital computation.	N/A	NYSE Rule Interpretation 322.15
Rule 4311-Carrying Agreements		
Rule 4311(a)(1) prohibits a member firm from entering into an agreement with a carrying firm for the carrying of its customer accounts on an omnibus or fully disclosed basis, unless the carrying firm is a FINRA member firm. This is a <i>new</i> provision for both NYSE and NASD members; however, the vast majority of carrying firms in the United States are FINRA member firms.	N/A	N/A
Rule 4311(a) (1) also includes a provision requiring that when an introducing firm acts as an intermediary for another introducing firm or firms (so-called "piggyback" or "intermediary clearing arrangements") for the purpose of obtaining clearing services from the carrying firm, the introducing firm must notify the carrying firm of the existence of the arrangement(s) with the other introducing firm(s) and disclose the identity of the firm(s). Further, each carrying agreement must identify and bind every direct and	N/A	NYSE Rule Interpretation 382/05

indirect recipient of clearing services as a party thereto.		
Rule 4311(b)(1) requires that the carrying firm must submit to FINRA for approval any agreement for the carrying of accounts, whether on an omnibus or fully disclosed basis, before such agreement can become effective. The proposed rule also provides that the carrying firm must also submit to FINRA for approval any material changes to an approved carrying agreement before the changes become effective.	N/A	NYSE 382(a)
Rule 4311(b)(1)(2) also codifies the practice under NASD Rule 3230 of permitting use of pre-approved standardized forms of agreement, with the exception of agreements with parties that are not U.S.-registered broker-dealers. The proposed rule requires a carrying firm to submit to FINRA for approval each carrying agreement with a non-U.S.-registered broker-dealer.	NASD Rule 3230	N/A
Rule 4311(b) (3) codifies the current practice under NYSE Rule 382 of requiring that as early as possible, but not later than 10 business days, prior to the carrying of any accounts of a new introducing firm (including the accounts of any piggyback or intermediary introducing firm(s)), the carrying firm must submit to FINRA a notice identifying each such introducing firm by name and CRD number and include such additional information as FINRA may require.	N/A	Current Practice under NYSE Rule 382
Rule 4311(b)(4) expressly requires each carrying firm to conduct appropriate due diligence with respect to any new introducing firm relationship, including, but not limited to, inquiry into the introducing firm's business mix and customer account activity, proprietary and customer positions, FOCUS and similar reports, audited financial statements and complaint and disciplinary history.	N/A	N/A
Rule 4311(d) requires that each customer whose account is introduced on a fully disclosed basis must be notified in writing upon the opening of the account, of the existence of the carrying agreement and the responsibilities allocated to each respective party. The proposed rule provides that the carrying firm would be responsible for the content of the notification to the customer. A <i>new</i> provision further provides that the customer must be notified promptly and in writing in the event of any change to any of the parties to the agreement or any material change to the allocation of responsibilities thereunder.	NASD Rule 3230(g)	NYSE Rule 382(c) and NYSE Rule Interpretation 382/03
Rule 4311(e) requires that each carrying agreement must expressly state that to the extent a particular responsibility is allocated to one party, the other party or parties will supply to the responsible organization all appropriate data in their possession pertinent to the proper performance and supervision of that responsibility.	N/A	NYSE Rule Interpretation 382/03
Rule 4311(f) provides that a carrying agreement may authorize an introducing firm to issue negotiable instruments directly to its customers, using instruments for which the carrying firm is the maker or drawer, provided that the parties comply with SEA Rule	NASD Rule 3230(d)	NYSE Rule 382(f)

15c3-3 and further that the introducing firm represents to the carrying firm in writing that the introducing firm maintains, and will enforce, supervisory policies and procedures with respect to such check writing that are satisfactory to the carrying firm.		
Rule 4311(g) (1) & Rule 4311(h) (1) generally address the obligations of the parties to provide the information required by the rule to each other and/or to FINRA, and are based upon existing rule provisions. It is also important to note that the July 1 deadline set forth in paragraph (h)(2) of the proposed rule differs from the current requirement (no later than July 31) specified by the corresponding NASD and NYSE rule provisions.	N/A	NYSE Rule 382(c) & 382(e)
Rule 4311(g)(2) provides that, upon a showing of good cause, FINRA, may exclude certain carrying firms from the requirements of the proposed FINRA Rule in instances where the introducing firm is an affiliated entity of the carrying firm.	NASD Rule 3230(b)(3)	N/A
Rule 4311(i) provides that all carrying agreements must require each introducing firm to maintain its proprietary and customer accounts, and the proprietary and customer accounts of any introducing firm for which it is acting as an intermediary in obtaining clearing services from the carrying firm, in such a manner as to enable the carrying firm and FINRA to specifically identify the proprietary and customer accounts belonging to each introducing firm. Consistent with NASD Rule 3230(h), the proposed rule's requirements apply only to intermediary clearing arrangements that are established on or after February 20, 2006.	NASD Rule 3230(h)	N/A
Rule 4522-Periodic Security Counts, Verifications and Comparisons		
Rule 4522(a) requires each member firm that is subject to the requirements of SEA Rule 17a-13 to make the counts, examinations, verifications, comparisons and entries set forth in SEA Rule 17a-13.	N/A	NYSE Rule 440.10
Rule 4522(b) requires each carrying or clearing member firm subject to SEA Rule 17a-13 to make more frequent counts, examinations, verifications, comparisons and entries where prudent business practice would so require.	N/A	NYSE Rule 440.10
Rule 4523-Assignment of Responsibility for General Ledger Accounts and Identification of Suspense Accounts		
Rule 4523 (a) requires that members designate an individual to be responsible for each general ledger account of the member firm. This individual is responsible for controlling and overseeing the entries into each such account and determining that it is current and accurate. The proposed rule requires that a supervisor must review each account at least monthly for accuracy, to determine that any items that are aged or uncertain as to resolution are promptly identified for research and possible transfer to a suspense account.	N/A	NYSE Rule 440.20

Rule 4523(b) requires that each carrying or clearing member firm must maintain a record of the name of each individual assigned primary and supervisory responsibility for each account as required by paragraph (a) of the rule.	N/A	NYSE Rule 440.20
Rule 4523(c) requires each member firm to record, in an account that must be clearly identified as a suspense account, money charges or credits and receipts or deliveries of securities whose ultimate disposition is pending determination. The proposed rule requires that member firms maintain a record of all information known with respect to each item so recorded.	N/A	NYSE 440.20

FOR MORE INFORMATION ON THIS OR OTHER BROKER-DEALER MATTERS, CONTACT:

Soo J. Yim +1 202 663 6958 soo.yim@wilmerhale.com
Bruce H. Newman +1 212 230 8835 bruce.newman@wilmerhale.com
Tiffany Smith +1 202 663 6241 tiffany.smith@wilmerhale.com

Wilmer Cutler Pickering Hale and Dorr LLP is a Delaware limited liability partnership. Our United Kingdom offices are operated under a separate Delaware limited liability partnership of solicitors and registered foreign lawyers regulated by the Solicitors' Regulation Authority. In Beijing, we are registered to operate as a Foreign Law Firm Representative Office. WilmerHale principal law offices: 60 State Street, Boston, Massachusetts 02109, +1 617 526 6000; 1875 Pennsylvania Avenue, NW, Washington, DC 20006, +1 202 663 6000. This material is for general informational purposes only and does not represent our legal advice as to any particular set of facts; nor does it represent any undertaking to keep recipients advised of all relevant legal developments. Prior results do not guarantee a similar outcome. © 2009 Wilmer Cutler Pickering Hale and Dorr LLP

wilmerhale.com