

---

## New FINRA Books and Records Rules

MAY 19, 2011

The Financial Industry Regulatory Authority ("FINRA") has announced newly approved books and records rules (Rules 2268, 4511, 4512, 4513, 4514, 4515, 5340 and 7440(a)(4)) that will go into effect on December 5, 2011.<sup>1</sup> In addition to consolidating and replacing existing requirements in NASD and NYSE rules, the new FINRA rules will impose a number of significant additional requirements on FINRA members. This memorandum highlights the principal new compliance obligations for FINRA members.

### **I. Default Six-Year Record Retention Period**

FINRA members will be required under Rule 4511 to preserve for a period of at least six years those books and records required to be preserved by FINRA rules for which there is no specified period under other FINRA rules or applicable rules under the Securities Exchange Act of 1934 (the "Exchange Act").<sup>2</sup>

The new rule states that it will apply to "FINRA books and records" without providing further elaboration. FINRA rules expressly require firms to maintain certain specified books and records<sup>3</sup> and also, more generally, books and records required to be preserved under the Exchange Act and the applicable Exchange Act rules.<sup>4</sup>

As a practical matter, the effect of the new requirement may be to cause FINRA members generally to seek to retain all books and records required by securities regulation for at least six years, except to the extent that a FINRA rule or an Exchange Act rule expressly provides for a shorter retention period. In addition, because Rule 4511(a) requires that all books and records required to be made pursuant to FINRA rules must be stored in compliance with Exchange Act Rule 17a-4, any such records retained electronically will need to be retained in accordance with the requirements of Exchange Act Rule 17a-4(f). Among other things, that provision requires that all books and records retained electronically be stored in non-rewritable, non-erasable formats known as "write once, read many" or "WORM."

## **II. Requirement to Maintain the Name(s) of the Associated Person(s) Responsible for Each Account**

FINRA members will be required under Rule 4512 to maintain the name(s) of the associated person(s), if any, responsible for each account. This requirement will replace the current requirement under NASD Rule 3110(c)(1)(C) requiring firms to maintain the signature of the registered representative introducing each account. Where a firm designates multiple individuals as being responsible for an account, the firm is required to maintain each of their names and a record indicating the scope of their responsibilities with respect to the account.<sup>5</sup>

## **III. Requirement to Maintain a Manual Signature of Each Individual Authorized to Trade Discretionary Accounts**

FINRA members will also be required under Rule 4512(a)(3) to maintain,

for discretionary accounts, a record of the dated, manual signature of each named natural person authorized to exercise discretion in the account (excluding investment discretion granted as to the price or the time at which to execute an order given by a customer for the purchase or sale of a definite dollar amount or quantity of a specified security).<sup>6</sup> Although the signature must be provided manually, for retention purposes firms may maintain and preserve the signature record on electronic storage media consistent with Exchange Act Rule 17a-4(f).

One commentator requested clarification regarding whether Rule 4512(a)(3) would be interpreted to require members to obtain manual dated signatures of all authorized agents of the customer, not just the firm's associated persons,<sup>7</sup> who exercise "discretion" in a client's account. The commentator noted that, taken in conjunction with a prior FINRA regulatory notice discussing a proposed consolidated rule governing discretionary accounts and transactions (*i.e.*, FINRA Regulatory Notice 09-63 discussing proposed Rule 3260), it would appear as though the reference to "natural person" in Rule 4512(a)(3) is directed towards associated persons only and not other authorized agents of customers (which are addressed separately in proposed Rule 3260).<sup>8</sup>

FINRA responded that by its terms, Rule 4512(a)(3) applies to "discretionary accounts" and that, for purposes of Rule 4512(a)(3), the term "discretionary accounts" includes any account that is considered a "discretionary account." FINRA stated that it will address the requirements applicable to other types of accounts in which a person is authorized by a customer to act on the customer's behalf in the context of its proposed changes to NASD Rule 2510 (Discretionary Accounts).<sup>9</sup> It is not clear from this response whether FINRA intends to require firms to obtain and maintain manual dated signatures of all persons authorized to trade in a customer's account,

including the account of an institutional customer that may have multiple employees with trading authority.

#### **IV. Requirement to Update Account Records**

FINRA members will also be required under Rule 4512 to update their records for accounts that were opened prior to the effectiveness of the new rule so that the records include the additional required items, *i.e.*, the name(s) of the associated person(s), if any, responsible for each account and, for discretionary accounts, the manual dated signature of each named natural person authorized to exercise discretion in the account.<sup>10</sup> However, the new rule permits FINRA members to make these updates in the course of their routine and customary business unless otherwise required by applicable laws or rules.<sup>11</sup>

#### **V. Clarification and Modification of Customer Complaint Retention Requirements**

FINRA Rule 4513 clarifies the existing requirement that firms keep and preserve in each office of supervisory jurisdiction ("OSJ") files of all written customer complaints by providing that the requirement covers only complaints that relate to the applicable OSJ (including complaints that relate to activities supervised from that office).<sup>12</sup> The new rule also clarifies that firms may satisfy the requirement by making the complaint records promptly available at the OSJ upon FINRA's request. The rule also requires that customer complaint records be preserved for a period of at least four years to take into account FINRA's four-year routine examination cycle.<sup>13</sup>

#### **VI. Other Clarifications and Updates**

#### A. Requirement to Maintain Account Information for Six Years After Updating and Account Closure

FINRA members will be required under Rule 4512 to preserve a record of any customer account information that has subsequently been updated for at least six years after the date of such update, and to preserve the most recently updated set of customer account information (or the original account information if there are no updates) for at least six years after the date the account is closed.<sup>14</sup>

#### B. Clarification of Requirement to Maintain Authorization Records for Negotiable Instruments from Customers

Under existing requirements, firms must get a customer's express written authorization before obtaining from a customer, or submitting for payment, a negotiable instrument drawn on the customer's checking, savings, share, or similar account.<sup>15</sup> FINRA Rule 4514 clarifies that in cases where customers provide firms an authorization that is separate from the negotiable instrument (rather than an authorization in the form of the customer's signature on the actual negotiable instrument), firms must preserve that authorization for three years following the date such authorization expires, since a customer authorization may remain in effect beyond three years from the date of the request.

#### C. Clarification of Requirement to Document the Essential Facts Regarding Changes in Account Names or Designations

Under existing requirements, before a customer order is executed, firms must place upon the order memorandum the name or designation of the account(s) for which such order is to be executed. No change in such account name(s) or designation(s) may be made unless the change has been approved in writing by a person who, prior to giving his or her approval, was personally informed of the essential facts relative to the change. The essential facts relied upon by the person approving the change must be documented in writing and preserved for three years.<sup>16</sup>

FINRA Rule 4515 supplements these existing requirements by clarifying that, with respect to any change in account name or designation that takes place prior to the execution of a trade, the essential facts the principal relied on in approving such change must be documented in writing *prior to execution*.

#### D. Expansion of Post-Execution Allocations Permitted to Be Received from Investment Advisers

Under existing requirements, when NYSE member firms accept block orders from investment advisers that are either registered under the Investment Advisers Act of 1940 (the "Advisers Act") or subject to state regulation, the firms may allow the investment advisers to make post-execution allocations on their block orders for customers on whose behalf the investment advisers submit the orders. The firms are required to receive specific account designations or customer names from the

investment advisers by the end of the business day.<sup>17</sup>

FINRA Rule 4515.01 expands the time permitted to receive specific account designations or customer names from investment advisers until noon of the next business day following the trading session.<sup>18</sup> The new rule applies to any order for the accounts of more than one customer.<sup>19</sup> Further, to cover all investment advisers, the new rule expands the types of investment advisers covered to include investment advisers who, but for Advisers Act Section 203(b), would need to register under the Advisers Act. The exception also covers associated persons of a member who provide investment advisory services on behalf of a member acting as an investment adviser. However, the exception does not apply to accounts handled by individual registered representatives who otherwise exercise discretion over a customer's account.<sup>20</sup>

#### E. Update to Required Disclosures Regarding Predispute Arbitration Agreements

Under existing requirements, predispute arbitration agreements are required to contain certain highlighted disclosures to help inform customers that they are agreeing to arbitrate.<sup>21</sup> Among other things, the required disclosures include a statement that the arbitrators do not have to explain the reason(s) for their award. FINRA Rule 2268 updates this disclosure to note that arbitrators are required, however, to provide an explained decision to the parties in eligible cases if there is a joint request by all parties at least 20 days before the first scheduled hearing date.<sup>22</sup> The updated disclosure is required to be in predispute arbitration agreements entered into on or after December 5, 2011.<sup>23</sup>

---

<sup>1</sup>See FINRA Regulatory Notice 11-19 (Apr. 2011), available at [www.finra.org/Industry/Regulation/Notices/2011/P123549](http://www.finra.org/Industry/Regulation/Notices/2011/P123549). The U.S. Securities and Exchange Commission ("SEC") approved the new rules on January 27, 2011. See Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change Adopting FINRA Rules Regarding Books and Records in the Consolidated FINRA Rulebook, Exchange Act Release No. 63784, 76 Fed. Reg. 5850 (Feb. 2, 2011) ("SEC Approving Release").

<sup>2</sup>See FINRA Rule 4511(b).

<sup>3</sup>E.g., Order audit trail system data (see FINRA Rule 7440(a)(4)(A)), records of office inspection dates (see NASD Rule 3010(c)(1)), records of foreign analysts relying on exemption from registration (see NASD Rule 1050(f)).

<sup>4</sup>See FINRA Rule 4511(a). Existing NASD Rule 3110(a) requires each FINRA member to "make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with the FINRA rules and as prescribed by Exchange Act Rule 17a-3. The record keeping format, media, and retention period shall comply with Rule 17a-4 under the [Exchange Act]."

<sup>5</sup> FINRA Rule 4512(a)(1)(C). For example, multiple associated persons may be responsible for an account that trades multiple product types (e.g., both equity and debt products) in cases where the associated persons each have product-specific responsibilities with respect to the account. This new FINRA requirement is similar to the requirement in Exchange Act Rules 17a-3(a)(6) and 17a-3(a)(7) that "the identity of each associated person, if any, responsible for the account" be included on each order memorandum and purchase or sale memorandum, respectively.

<sup>6</sup> FINRA Rule 4512(a)(3). This FINRA requirement is consistent with the current Exchange Act Rule 17a-3(a)(17)(ii) requirement that, for each account with a natural person as a customer or owner, broker-dealers maintain a record containing the dated signature of each customer or owner granting the authority and the dated signature of each natural person to whom discretionary authority is granted.

<sup>7</sup> An "associated person" of a FINRA member generally means (1) a natural person who is registered or has applied for registration under the FINRA rules; and (2) a sole proprietor, partner, officer, director, or branch manager of a FINRA member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a FINRA member, whether or not any such person is registered or exempt from registration with FINRA. FINRA By-Laws Article I(rr).

<sup>8</sup>See Letter from Melissa MacGregor, Securities Industry and Financial Markets Association (SIFMA) Managing Director and Associate General Counsel (Nov. 23, 2010), *available at* [www.sec.gov/comments/sr-finra-2010-052/finra2010052-3.pdf](http://www.sec.gov/comments/sr-finra-2010-052/finra2010052-3.pdf).

<sup>9</sup>See Letter from Afshin Atabaki, FINRA Assistant General Counsel (Jan. 13, 2011), *available*

at [www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p122795.pdf](http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p122795.pdf).

<sup>10</sup> FINRA Rule 4512(b).

<sup>11</sup> *Id.*

<sup>12</sup> See NASD Rule 3110(d).

<sup>13</sup> Exchange Act Rules 17a-3(a)(18) and 17a-4(b)(1) require complaint records to be preserved for three years.

<sup>14</sup> FINRA Rule 4512.01.

<sup>15</sup> See NASD Rule 3110(g).

<sup>16</sup> See NASD Rule 3110(j).

<sup>17</sup> See NYSE Rule Interpretation 410 /02.

<sup>18</sup> See FINRA Regulatory Notice 11-19.

<sup>19</sup> *Id.*

<sup>20</sup> See the SEC Approving Release at 5853.

<sup>21</sup> See NASD Rule 3110(f).

<sup>22</sup> See FINRA Rule 2268(a)(4).



<sup>23</sup>See FINRA Regulatory Notice 11-19.

---

## *Authors*



**Yoon-Young Lee**

SENIOR COUNSEL

✉ [yoonyoung.lee@wilmerhale.com](mailto:yoonyoung.lee@wilmerhale.com)

☎ +1 202 663 6720



**Bruce H. Newman**

PARTNER

✉ [bruce.newman@wilmerhale.com](mailto:bruce.newman@wilmerhale.com)

☎ +1 212 230 8835