

FINRA Issues Proposals on Rulebook Consolidation

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What This Means

FINRA has issued four proposals to consolidate existing NASD and NYSE rules into a single rulebook. Comments on the proposals are due to FINRA by June 13, 2008. The proposals are preliminary—they still must be filed with and adopted by the SEC before they can take effect. However, these proposals represent the first formal steps toward creating a single rulebook for broker-dealers that are FINRA members, which was a main objective of last year's consolidation of member regulatory functions into a single SRO. FINRA indicated that the creation of this single rulebook will be accomplished in phases, with substantial completion during the next year.

Discussion and Analysis

FINRA's proposals cover four areas: financial responsibility, supervision and supervisory controls, books and records, and investor education and protection. The more notable aspects of the proposals include the following:

Financial Responsibility

Certain aspects of the financial responsibility proposal would apply existing NYSE rules to non-NYSE member firms. However, the scope of these FINRA rules generally would be limited to clearing firms, meaning that nonclearing NYSE members would no longer be subject to these requirements.

- **Authority to Increase Capital Requirements (based primarily on NYSE Rule 325(d)).** FINRA would be able to impose increased net capital requirements on a clearing firm or direct a clearing firm to restore or increase its net capital or net worth when deemed necessary for the protection of investors or in the public interest.
- **Withdrawal of Equity Capital (based partly on NYSE Rule 312(h)).** Clearing firms would be required to obtain FINRA's written approval to withdraw equity capital for a period of one year after contribution or to make distributions over a rolling 35-calendar-day period that would exceed 10% of the clearing firm's net capital.
- **Regulatory Notification (based on NYSE Rule 325(b)).** Clearing firms would be required to notify FINRA within 24 hours if certain specified financial triggers are reached.

Supervision and Supervisory Controls

- **Documentation and Supervision of Supervisory Personnel.** The proposal would eliminate the prescriptive provisions currently in effect regarding the supervision of a producing manager's customer account activity, including the requirement to impose heightened supervision when any producing manager's revenues rise above a specific threshold. Those provisions would be replaced with a principles-based requirement that firms have procedures to address potential abuses in connection with the supervision of supervisors.

- **Supervisory Controls Reports.** The proposal would incorporate the existing requirement under NASD and NYSE rules that a member firm prepare and submit a report to its senior management summarizing the results of the firm’s testing of its supervisory controls and any necessary amendments to those controls. The consolidated requirement also would incorporate the supervisory controls report content requirements of NYSE Rule 342.30, which would apply to firms that reported \$150 million or more in gross revenue for the prior calendar year.
- **Risk-Based Review of Transactions.** The proposal would incorporate the existing NASD and NYSE requirements that a registered principal review all transactions, but would add supplementary material to provide that the review could be risk based.
- **Supervision of Outside Business Activities.** The proposal would incorporate the existing NASD and NYSE requirements on outside business activities, but would add an exception from applicable supervisory requirements for certain bank-related securities activities of a dual employee.
- **Review of Customer Complaints.** The proposal would incorporate existing NASD and NYSE requirements regarding customer complaints, but the consolidated requirement would be limited to written (including electronic) customer complaints.

Books and Records

- **Customer Account Information.** The proposal would incorporate the existing requirements under NASD rules that firms maintain certain information relating to customer accounts. However, the proposal would simplify the requirement by providing that firms could maintain the name of any associated person responsible for the account rather than the signature of the registered representative introducing the account.
- **Discretionary Accounts.** The proposal would make a number of clarifications to the existing NASD and NYSE requirements regarding discretionary accounts, including that firms must maintain discretionary accounts and exercise discretion in such accounts only to the extent permitted under the federal securities laws.

Investor Education and Protection

- The proposal would incorporate the existing requirement under NASD rules that firms provide customers with information about FINRA’s “BrokerCheck” program and the FINRA website address. In addition, the proposal would clarify that the information may be provided electronically to customers.

To view FINRA’s announcement of the proposals, which includes links to the proposals themselves, please visit: <http://www.finra.org/PressRoom/NewsReleases/2008NewsReleases/P038499>.

How Morgan Lewis Can Help

This FYI provides just some of the highlights of FINRA’s comprehensive proposals. Morgan Lewis’s Broker-Dealer and Capital Markets Regulation Practices regularly advise clients on the application of FINRA rules and the potential impact of SRO rule proposals. If you have any questions concerning these important legal developments, please contact any of the following Morgan Lewis attorneys:

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