

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63260; File No. SR-FINRA-2010-034)

November 5, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filings of Amendments No. 1 and 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Amended, to Adopt FINRA Rule 4530 (Reporting Requirements) in the Consolidated FINRA Rulebook

I. Introduction

On July 30, 2010, the Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposal to (i) adopt NASD Rule 3070 (Reporting Requirements) as FINRA Rule 4530 in the Consolidated FINRA Rulebook, with certain amendments and the addition of a supplementary material section, and (ii) delete paragraphs (a) through (d) of Incorporated NYSE Rule 351 and Incorporated NYSE Rules 351.10 and 351.13. The proposal was published for comment in the Federal Register on August 9, 2010.³ The Commission received seven comments on the proposal.⁴ On October 18, 2010,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 62621 (July 30, 2010), 75 FR 47863 (August 9, 2010) (“Notice”).

⁴ See letter from Brendan Daly, Legal and Compliance Counsel, Commonwealth Financial Network, to Elizabeth M. Murphy, Secretary, Commission, dated August 27, 2010 (“Commonwealth Letter”); letter from Kristin Bulls, Products and Broker-Dealer Compliance Director, State Farm VP Management Corp., to Elizabeth M. Murphy, Secretary, Commission, dated August 30, 2010 (“State Farm Letter”); letter from Joan Hinchman, Executive Director, President and CEO, National Society of Compliance Professionals, to Elizabeth M. Murphy, Secretary, Commission, dated August 30, 2010 (“NSCP Letter”); letter from Clifford E. Kirsch and Susan S. Krawczyk, Sutherland Asbill & Brennan LLP, on behalf of the Committee of Annuity Insurers, to Elizabeth M. Murphy, Secretary, Commission, dated August 30, 2010 (“CAI Letter”); letter from

FINRA responded to the comments and filed Amendment No. 1 to the proposed rule change.⁵

On October 22, 2010, FINRA filed Amendment No. 2 to the proposed rule change.⁶ The Commission is publishing this notice and order to solicit comments on Amendments No. 1 and 2 and to approve the proposed rule change, as amended, on an accelerated basis.

II. Description of the Proposal, as Modified by Amendments No. 1 and 2

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”), FINRA proposes to (i) adopt NASD Rule 3070 (Reporting Requirements) as FINRA Rule 4530 in the Consolidated FINRA Rulebook, subject to certain amendments

Michael Lesutis, Assistant General Counsel, PFS Investments, Inc., to Elizabeth M. Murphy, Secretary, Commission, dated September 1, 2010 (“PFS Letter”); letter from James T. McHale, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, to Elizabeth M. Murphy, Secretary, Commission, dated September 1, 2010 (“SIFMA Letter”); letter from Dale E. Brown, President and CEO, Financial Services Institute, to Elizabeth M. Murphy, Secretary, Commission, dated September 15, 2010 (“FSI Letter”).

⁵ See Amendment No. 1, dated October 18, 2010 (“Amendment No. 1”). The text of Amendment No. 1 is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA, and on the Commission’s website, <http://www.sec.gov/rules/sro.shtml>. In Amendment No. 1, FINRA responded to the comment letters received regarding the Notice and revised the proposed rule change. Among other things, FINRA proposes to amend (i) proposed FINRA Rule 4530(a)(1)(G) to require the reporting of any claims for damages by a customer, broker or dealer that relates to the provision of financial services or relates to a financial transaction; (ii) proposed Supplementary Material .01 to provide clarity on what internal conclusions of violative conduct a member must report pursuant to proposed FINRA Rule 4530(b); (iii) proposed Supplementary Material .07 to clarify the circumstances under which a firm would not be required to report information relating to a former associated person; (iv) proposed Supplementary Material .08 to clarify a member’s reporting obligations regarding customer complaints pursuant to proposed FINRA Rules 4530(a)(1)(B) and 4530(d); and (v) proposed Supplementary Material .09 to provide a definition for the term “financial-related.”

⁶ See Amendment No. 2 dated October 22, 2010 (“Amendment No. 2”). The text of Amendment No. 2 is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA, and on the Commission’s website, <http://www.sec.gov/rules/sro.shtml>. In Amendment No. 2, FINRA proposes to further amend proposed Supplementary Material .07 to clarify the circumstances under which a firm would not be required to report information relating to a former associated person.

described below and the addition of a supplementary material section as detailed below and (ii) delete paragraphs (a) through (d) of Incorporated NYSE Rule 351 and Incorporated NYSE Rules 351.10 and 351.13 from the Transitional Rulebook.

NASD Rule 3070 and Incorporated NYSE Rule 351 require members to report to FINRA certain specified events (e.g., regulatory actions, certain customer settlements, securities-related law suits or arbitrations, etc.), to file with FINRA documents related to such events, and to report to FINRA quarterly statistical and summary information regarding written customer complaints. FINRA uses the reported information for regulatory purposes; the information, among other things, assists FINRA in identifying and investigating firms, offices and associated persons that may pose a regulatory risk.⁷

Because proposed FINRA Rule 4530 is based upon NASD Rule 3070, the following description sets forth a summary of the ways in which proposed FINRA Rule 4530 differs from NASD Rule 3070.

A. Reporting Deadline (Proposed FINRA Rules 4530(a) and 4530.03)

The substantive changes to proposed FINRA Rule 4530(a) clarify that a firm must report to FINRA after the firm “knows or should have known” of the existence of any of the events specified in paragraph (a) of the proposed rule and extends the time period for reporting the events from 10 business days (as provided under NASD Rule 3070(b)) to no later than 30 calendar days after the firm knows or should have known of the event. FINRA states that the proposed 30-calendar-day reporting deadline is consistent with Incorporated NYSE Rule 351⁸ and the reporting deadlines for disclosing information on forms BD (Uniform Application for

⁷ See Notice, supra note 3, 75 FR at 47863.

⁸ See Incorporated NYSE Rule 351(b); NYSE Information Memo 90-17, “Timely and Complete Filings and Responses to Enforcement Inquiries” (April 30, 1990) (defining “prompt” filing as occurring within 30 days of the reportable event).

Broker-Dealer Registration),⁹ U4 (Uniform Application for Securities Industry Registration or Transfer)¹⁰ and U5 (Uniform Termination Notice for Securities Industry Registration)¹¹ (collectively referred to as the “Uniform Forms”).

B. External Findings (Proposed FINRA Rule 4530(a)(1)(A))

NASD Rule 3070(a)(1) requires a firm to report findings of violations of “any provision of any securities laws, or regulation, any rule or standards of conduct of any governmental agency, self-regulatory organization, or financial business or professional organization.”

Proposed FINRA Rule 4530(a)(1)(A) would instead require a firm to report findings of violations of any “securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body, self-regulatory organization or business or professional organization” and eliminates the requirement for firms to report findings that a member or associated person has engaged in conduct inconsistent with just and equitable principles of trade.¹² Proposed Supplementary Material .03 clarifies the meaning of the term “found” for the purpose of determining when a firm or associated person has been “found to have” engaged in violative conduct.

C. Civil Litigation or Arbitration; Claims for Damages (Proposed FINRA Rule 4530(a)(1)(G), 4530.06 and 4530.09)

As proposed, FINRA Rule 4530(a)(1)(G) extends the reporting requirement relating to securities- and commodities-related civil suits and arbitrations and claims for damages by customers and broker-dealers disposed of by judgment, award or settlement (in an amount

⁹ See Article IV, Section 1 of FINRA’s By-Laws.

¹⁰ See Article V, Section 2 of FINRA’s By-Laws.

¹¹ See Article V, Section 3 of FINRA’s By-Laws.

¹² FINRA members would still be required to report findings of violations of an SRO’s just and equitable principles of trade rule, such as FINRA Rule 2010. See Notice, supra note 3, 75 FR at 47864.

exceeding certain monetary thresholds) to include “any financial-related insurance civil litigation or arbitration” but limits the requirement to report claims for damages by customers, brokers or dealers to those claims for damages that relate to the provision of financial services or a financial transaction.¹³ Proposed Supplemental Material .06 clarifies that for purposes of determining whether a civil suit, arbitration or claim for damages exceeds the monetary threshold and must be reported pursuant to proposed FINRA Rule 4530(a)(1)(G), (1) members must take into account awards of attorneys fees and interest, and (2) if parties are subject to “joint and several” liability, each party is considered separately liable for the aggregate amount.¹⁴ Proposed Supplemental Material .09 defines the term “financial related” to mean “related to the provision of financial services.”¹⁵

D. Statutory Disqualifications (Proposed FINRA Rule 4530(a)(1)(H))

Proposed FINRA Rule 4530(a)(1)(H) modifies the reporting requirement in NASD Rule 3070(a)(9) relating to statutory disqualifications to clarify that a member must report to FINRA whenever the member itself is subject to a “statutory disqualification,” or whenever an associated person of the firm is subject to a “statutory disqualification.” While NASD Rule 3070(a)(9) requires a member to report to FINRA if the member or an associated person of the member “is associated in any business or financial activity” with a person subject to a “statutory disqualification,” proposed FINRA Rule 4530(a)(1)(H) instead requires a member to report to FINRA whenever the member or an associated person of the member “is involved in the sale of

¹³ See proposed FINRA Rule 4530(a)(1)(G), as modified by Amendment No. 1.

¹⁴ See proposed FINRA Rule 4530.06.

¹⁵ See proposed FINRA Rule 4530.09, as modified by Amendment No. 1.

any financial instrument, the provision of any investment advice or the financing of any such activities” with a person subject to a “statutory disqualification.”¹⁶

E. Internal Disciplinary Actions Against Associated Persons (Proposed FINRA Rule 4530(a)(2))

Similar to NASD Rule 3070(a)(10), proposed FINRA Rule 4530(a)(2) requires a firm to report certain disciplinary actions taken by the firm against its associated persons. Proposed FINRA Rule 4530(a)(2), states that disciplinary actions involving the withholding of compensation or of any other remuneration in excess of \$2,500 are reportable events (as opposed to just the withholding of commissions, as provided by NASD Rule 3070(a)(10)).

F. Internal Conclusions (Proposed FINRA Rules 4530(b), 4530.01 and 4530.02)

Proposed FINRA Rule 4530(b) requires firms to report internal conclusions of certain enumerated violative conduct.¹⁷ Specifically, a firm would be required to report to FINRA no later than 30 calendar days after the firm has concluded, or reasonably should have concluded, that an associated person of the firm or the firm itself has violated any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body or SRO.

Pursuant to proposed Supplementary Material .01, if a firm disciplines an associated person in the manner described in proposed FINRA Rule 4530(a)(2), the firm would be required

¹⁶ FINRA notes that this provision is consistent with Incorporated NYSE Rule 351(a)(9). See Notice, supra note 3, 75 FR at 47864.

¹⁷ FINRA notes that this proposed rule is generally based on Incorporated NYSE Rule 351(a)(1), which requires a firm to report whenever it or its associated persons have violated any provision of any securities law or regulation, any agreement with or rule or standard of conduct of any governmental agency, self-regulatory organization (“SRO”), or business or professional organization, or engaged in conduct that is inconsistent with just and equitable principles of trade or detrimental to the interests or welfare of the NYSE. See Notice, supra note 3, 75 FR at 47864.

to report the event under proposed FINRA Rule 4530(a)(2).¹⁸ In addition, proposed Supplementary Material .01 clarifies that FINRA only expects a member to report internal conclusions pursuant to proposed FINRA Rule 4530(b) relating to violative conduct that has widespread or potentially widespread effect on the member, its customers or markets, or, in the case of violative conduct of the member, that arises from a material failure of the member's systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts, or, in the case of violative conduct by an associated person, has a significant monetary result with respect to a member(s), customer(s) or market(s) or where there are multiple instances of any violative conduct.¹⁹

In addition, proposed Supplementary Material .02 states that proposed FINRA Rule 4530(b) only requires reporting where a member has concluded or reasonably should have concluded on its own that violative conduct has occurred, as opposed to where there has been a finding of violative conduct by an external body, such as a court, domestic or foreign regulatory body, SRO or business or professional organization (which would be reportable pursuant to proposed FINRA Rule 4530(a)(1)(A)).²⁰

G. Reporting Obligation (Proposed FINRA Rule 4530(e))

Similar to NASD Rule 3070(d), proposed FINRA Rule 4530(e) provides that proposed FINRA Rule 4530 does not relieve a firm or an associated person from other obligations, such as the requirement to disclose information on the Uniform Forms, as applicable. In addition, proposed FINRA Rule 4530(e) clarifies that a firm must comply with the reporting obligations

¹⁸ See proposed FINRA Rule 4530.01, as modified by Amendment No. 1.

¹⁹ Id.

²⁰ See proposed FINRA Rule 4530.02.

under proposed FINRA Rules 4530(a) and (b) and must report quarterly statistical and summary information regarding written customer complaints pursuant to proposed FINRA Rule 4530(d), regardless of whether such information is reported or disclosed pursuant to any other rule or requirement, including the requirements of the Forms BD or U4.²¹

H. Elimination of the Exemption for Dual Members Subject to Another SRO's Rule

Proposed FINRA Rule 4530 does not include the exemption set forth in NASD Rule 3070(e) for firms subject to substantially similar reporting requirements of another SRO because this provision was intended to exempt Dual Members subject to the reporting requirements of NASD Rule 3070 and the reporting requirements of Incorporated NYSE Rule 351.²²

I. Filing of Related Documents with FINRA (Proposed FINRA Rule 4530(f))

Consistent with NASD Rule 3070(f), proposed FINRA Rule 4530(f) requires a firm to file copies of certain criminal and civil complaints and arbitration claims with FINRA.

However, proposed FINRA Rule 4530(f) expands the filing requirement to include (1) copies of any complaint in which a member is named as a defendant or respondent in any “financial-related insurance private civil litigation” and (2) any “financial-related insurance arbitration claim” filed against a member in any forum other than the FINRA Dispute Resolution forum.

J. Additional Supplementary Material (Proposed FINRA Rules 4530.05, .07 and .08)

In addition to the supplementary material discussed above, FINRA also proposes as supplementary material the following clarifications: (1) for purposes of proposed FINRA Rules 4530(a) and (b), firms should not report a single event under more than one paragraph or

²¹ Proposed FINRA Rule 4530(e) provides that a firm is not required to report an event otherwise required to be reported under proposed FINRA Rules 4530(a) or (b) if the firm discloses the event on a Form U5, consistent with the requirements of that form.

²² See Notice, supra note 3, 75 FR at 47865.

subparagraph; however, members may be required to report related events under more than one paragraph or subparagraph;²³ (2) for purposes of proposed FINRA Rules 4530(a), (b) and (d), firms should report an event relating to a former associated person if the event occurred while the individual was associated with the member; however, a member is not required to report such an event where, based on its records or information available through Web CRD, the member cannot determine that the person was an associated person of the member;²⁴ and (3) any written customer complaint reported under proposed FINRA Rule 4530(a)(1)(B) must also be reported pursuant to proposed FINRA Rule 4350(d);²⁵ however, for the purpose of reporting under proposed FINRA Rule 4350(d), a member must report (1) any written grievance involving the member or its associated person by a person, other than a broker or dealer, with whom the member has engaged in securities activities and (2) any securities-related written grievance involving the member or its associated person and any written complaint reportable under proposed Rule 4530(a)(1)(B) by a person other than a broker or dealer, with whom the member has sought to engage in securities activities.²⁶

K. Deletion of Certain Incorporated NYSE Provisions

FINRA proposes to delete paragraphs (a) through (d) of Incorporated NYSE Rule 351 and NYSE Rules 351.10 and 351.13 because these provisions are substantially similar to,

²³ See proposed FINRA Rule 4530.05.

²⁴ See proposed FINRA Rule 4530.07.

²⁵ Proposed FINRA Rule 4530(a)(1)(B) is identical to NASD Rule 3070(a)(2) and requires a member to report to FINRA if the member or an associated person of the member is the subject of any written customer complaint involving allegations of theft or misappropriation of funds or securities or of forgery.

²⁶ See proposed FINRA Rule 4530.08.

otherwise incorporated in, or rendered obsolete by proposed FINRA Rule 4530, or addressed by other rules.²⁷

III. Summary of Comments and FINRA's Response

The Commission received seven comment letters to the proposed rule change.²⁸ FINRA responded to the comments and modified the proposed rule change in Amendments No. 1 and 2.

A. Reporting of Insurance-related External Findings under proposed FINRA Rule 4530(a)(1)(A)

FINRA Rule 4350(a)(1)(A) requires members to report, among other things, external findings of violations of insurance-related laws, rules, or regulations. One commenter believes that the requirement to report insurance-related external findings is unwarranted, burdensome, and outside the scope of FINRA's authority.²⁹ The commenter argues that reportable external findings should be limited to those that derive from a transaction with a customer.³⁰ FINRA responds that current NASD Rule 3070(a)(1) requires a member to report external findings relating to violations of any rule or standard of conduct of any governmental agency, SRO, or financial business or professional organization.³¹ Therefore, members are currently required to report external findings related to insurance matters and the proposed rule simply continues this requirement and is consistent with other provisions of FINRA's rules.³² Finally, FINRA states

²⁷ See Notice, supra note 3, 75 FR at 47866.

²⁸ See supra, note 4.

²⁹ See State Farm Letter.

³⁰ Id.

³¹ See Amendment No. 1 at 7.

³² Id. FINRA points to NASD Rule 3070(a)(3) and NYSE Rule 351(a)(3) (requiring reporting where a firm or an associated person is named as a defendant or respondent in any proceeding brought by a regulatory or self-regulatory body alleging the violation of any insurance laws, rules or regulations), NASD Rule 3070(a)(4) and NYSE Rule 351(a)(4) (requiring reporting where a firm or an associated is disciplined by any

that this information is relevant because it assists FINRA in identifying members and associated persons that may pose a regulatory risk.³³

In response to a comment that FINRA should provide additional guidance regarding what members should identify and report pursuant to proposed FINRA Rule 4530(a)(1)(A),³⁴ FINRA notes that proposed Supplementary Material .02, which states that FINRA Rule 4530(a)(1)(A) is limited to situations where there has been a finding of violative conduct by an external body, such as a court, domestic or foreign regulatory body, SRO or business or professional organization.³⁵

B. Civil Litigation or Arbitration and Other Claims for Damages under proposed FINRA Rule 4350(a)(1)(G)

Proposed Rule 4530(a)(1)(G) requires that members report any “insurance” civil litigation or arbitration that is “financial-related.” Three commenters opined that the term “financial-related” is ambiguous and needs greater clarification.³⁶ In response, FINRA amended its proposal to add Supplementary Material .09, which defines the term “financial-related” to mean “related to the provision of financial services.”³⁷

insurance regulatory or self-regulatory body, is denied membership or continued membership in any such self-regulatory body, or is barred from becoming associated with any member of any such self-regulatory body), and NASD Rule 3070(a)(6) and NYSE Rule 351(a)(6) (requiring reporting where a firm or an associated person is a director, controlling stockholder, partner, officer, sole proprietor, or an associated person of an insurance company that was suspended, expelled or had its registration denied or revoked).

³³ Id.

³⁴ See NSCP Letter.

³⁵ See Amendment No. 1 at 7-8.

³⁶ See CAI Letter, NSCP Letter and State Farm Letter.

³⁷ See proposed FINRA Rule 4530.09.

Two commenters believe that the reporting of insurance-related civil litigation and arbitration should be limited to insurance products that are securities.³⁸ FINRA clarifies that the proposed rule would exclude civil litigation and arbitration related to certain insurance products, such as traditional auto and health insurance, but would include civil litigation and arbitration involving non-securities insurance products related to the provision of financial services.³⁹ FINRA does not believe that the proposed rule should be limited to insurance products that are securities.⁴⁰

As initially proposed, proposed Rule 4530(a)(1)(G) required the reporting of claims for damages by customers that were “financial or transactional in nature.”⁴¹ Two commenters requested further clarification to effectively identify and report insurance matters relevant to FINRA.⁴² In response to these comments, FINRA revised the language of proposed Rule 4530(a)(1)(G) to require reporting of any claim for damages that relates to the provision of financial services or relates to a financial transaction.⁴³

C. Reporting of Internal Conclusions under proposed FINRA Rule 4530(b)

Proposed FINRA Rule 4350(b) requires members to report to FINRA certain internal conclusions of violative conduct.⁴⁴ As initially proposed, Supplementary Material .01 stated that FINRA Rule 4530(b) would not require a member to report an isolated violation by the member

³⁸ See CAI Letter and NSCP Letter.

³⁹ See Amendment No. 1 at 8.

⁴⁰ Id.

⁴¹ See Notice, supra note 3, 75 FR at 47864.

⁴² See NSCP Letter and State Farm Letter.

⁴³ See proposed FINRA Rule 4350(a)(1)(G), as modified by Amendment No. 1.

⁴⁴ See proposed FINRA Rule 4350(b).

or an associated person of the member that could be reasonably viewed as a ministerial violation that did not result in customer harm and was remedied promptly upon discovery.⁴⁵

Four commenters argued that the provisions of proposed FINRA Rules 4530(b) and Supplementary Material .01 are unduly burdensome, overly broad and costly,⁴⁶ and two requested elimination of the reporting requirement.⁴⁷ In response, FINRA notes that NYSE Rule 351(a)(1) requires firms to report internal conclusions of violative conduct and that FINRA's examination programs use this information as part of their assessment processes and risk-based analyses.⁴⁸

All commenters believe that the requirements of proposed FINRA Rule 4530(b) and the language in Supplementary Material .01 are vague and that FINRA should clarify and provide examples of what internal conclusions are required be reported.⁴⁹ Some of these commenters suggest that FINRA should adopt the reporting standard and interpretive guidance set forth in NYSE Information Memorandum 06-11.⁵⁰ In response to these comments, FINRA noted that it continues to believe the standard set forth in NYSE Information Memorandum 06-11 is too narrow⁵¹ but amended Supplementary Material .01 to further clarify what internal conclusions of violative conduct FINRA expects a member to report.⁵²

⁴⁵ See Notice, supra note 3, 75 FR at 47865.

⁴⁶ See CAI Letter, Commonwealth Letter and NSCP Letter.

⁴⁷ See CAI Letter and State Farm Letter.

⁴⁸ See Amendment No. 1 at 10.

⁴⁹ See CAI Letter, Commonwealth Letter, FSI Letter, NSCP Letter, PFS Letter, SIFMA Letter and FSI Letter.

⁵⁰ See CAI Letter, Commonwealth Letter, FSI Letter and PFS Letter.

⁵¹ Id. at 15.

⁵² See proposed FINRA Rule 4350.01, as modified by Amendment No. 1.

Two commenters believe that the term “concluded” is vague.⁵³ FINRA responds that a firm is free to determine the persons responsible for concluding that a violation has occurred. FINRA stated that a firm cannot defend against a failure to report such conduct by asserting that the conduct was of a nature that did not merit consideration by a person of seniority.⁵⁴ In addition, FINRA notes that if someone within a firm reaches a conclusion of violation, but upon review, senior management reaches a different conclusion, a firm could rely on senior management’s determination, provided it is reasonable.⁵⁵

A number of commenters took issue with the requirement to report violative conduct pursuant to proposed FINRA Rule 4350(b) if a member “reasonably should have concluded” a violation occurred, arguing it will create uncertainty, result in inconsistent application, and could be used in hindsight by FINRA to pursue a firm if FINRA concludes after-the-fact that the firm should have reported.⁵⁶ In response, FINRA clarifies that if a reasonable person would have concluded that a violation occurred, then the matter is reportable, and if a reasonable person would not have concluded that a violation occurred, then the matter is not reportable; FINRA will rely on a firm’s good-faith reasonable determination.⁵⁷

Numerous commenters expressed concern that FINRA’s statement that the existence of internal audit findings creates a strong presumption that a matter is reportable⁵⁸ could undermine the internal audit process at member firms.⁵⁹ Similarly, commenters believe FINRA’s

⁵³ See NSCP Letter and State Farm Letter.

⁵⁴ See Amendment No. 1 at 11.

⁵⁵ See Amendment No. 1 at 11-12.

⁵⁶ See CAI Letter, Commonwealth Letter, FSI Letter, NSCP Letter and SIFMA Letter.

⁵⁷ See Amendment No. 1 at 13.

⁵⁸ See Notice, *supra* note 3, 75 FR at 47867.

⁵⁹ See Commonwealth Letter, NSCP Letter and SIFMA Letter.

statement⁶⁰ that matters subject to a firm's internal review processes as required under other FINRA rules are subject to being reported as internal conclusions under proposed FINRA Rule 4530(b) could be problematic.⁶¹ One commenter believes this could result in firms diluting their internal control findings.⁶² Two commenters point out that this runs counter to previous guidance by NASD that it would not use the reports and review processes contemplated by NASD Rules 3012 and 3013 as a roadmap for disciplinary action against firms.⁶³ FINRA responds that the reporting obligation under proposed FINRA Rule 4350(b) and the internal review processes set forth under other rules (e.g., FINRA Rule 3130) are mutually exclusive and that, while internal review processes may inform a member's determination that a violation occurred, they do not by themselves lead to the conclusion that a matter is reportable under proposed FINRA Rule 4350(b).⁶⁴ FINRA notes that it would not view a discussion in an internal audit report regarding the need for enhanced controls in a particular area alone as determinative of a reportable violation under proposed FINRA Rule 4350(b).⁶⁵ FINRA also clarifies that, rather than creating a strong presumption, an internal audit finding would serve only as one factor, among others, that a firm should consider in determining whether violative conduct occurred.⁶⁶ Furthermore, FINRA has stated that it believes that the goals of customer protection and market integrity necessitate the reporting of such conduct to FINRA.⁶⁷

⁶⁰ See Notice, *supra* note 3, 75 FR at 47867.

⁶¹ See CAI Letter, Commonwealth Letter and SIFMA Letter.

⁶² See SIFMA Letter.

⁶³ See CAI Letter and Commonwealth Letter.

⁶⁴ See Amendment No. 1 at 14-15.

⁶⁵ See Amendment No. 1 at 15.

⁶⁶ Id.

⁶⁷ See Notice, supra note 3, 75 FR at 47867.

D. Customer Complaints

Proposed FINRA Rule 4530(d) requires members to submit monthly reports to FINRA regarding written customer complaints received by the member. A member would not be required to report written complaints relating to non-securities products, if such complaints are not from customers that the member has engaged, or has sought to engage, in securities activities.⁶⁸ If a member has engaged, or has sought to engage, in securities activities with a person, then any written complaint from that person is reportable, regardless of whether it relates to non-securities products.⁶⁹ One commenter stated that it would be difficult to determine with whom a firm has “sought to engage” in securities activities, and also expressed concern regarding the potential number of non-securities related complaints it would have to report in connection with customers it “sought to engage” in securities activities.⁷⁰ In response, FINRA notes that the definition of “customer” under NASD Rule 3070(c) includes persons with whom a member has “sought to engage” in securities activities and, therefore, firms should currently have procedures to identify whether a person submitting a written complaint is someone that the firm has sought to engage in securities activities. In addition, FINRA amended proposed Supplementary Material .08 to clarify circumstances under which a member would be required to report, pursuant to proposed FINRA Rules 4530(d) and 4530(a)(1)(B), complaints from persons

⁶⁸ See Notice, supra note 3, 75 FR at 47868. Proposed Supplementary Material .08 defines “customer” as any person, other than a broker or dealer, with whom a member has engaged, or has sought to engage, in securities activities. This definition is identical to the definition of “customer” contained in NASD Rule 3070(c).

⁶⁹ Id.

⁷⁰ See State Farm Letter.

with whom the member has engaged in securities activities versus persons with whom the member has sought to engage in securities activities.⁷¹

E. Duplicative Reporting

Three commenters believe that FINRA should completely eliminate duplicative reporting requirements under proposed FINRA Rule 4530(e) and Forms U4, U5 and BD.⁷² FINRA responds that it will work toward this goal and that proposed FINRA Rule 4530(e) will eliminate duplicative reporting of information disclosed on the Form U5.⁷³

F. Former Associated Persons

Two commenters argued that the requirement to report certain events related to former associated persons would be unduly burdensome and recommend that the requirement be amended to conform to the record retention requirements of Rule 17a-4 of the Act⁷⁴ and the reporting period for formerly associated persons be capped at three years.⁷⁵ In response, FINRA revised proposed Supplementary Material .07 to state that a firm is not required to report information with respect to a former associated person where, based on its records or information available through Web CRD, the member cannot determine whether the person was an associated person.⁷⁶

G. Other Comments

⁷¹ See proposed FINRA Rule 4530.08, as modified by Amendment No. 1.

⁷² See CAI Letter, FSI Letter and SIFMA Letter.

⁷³ See Amendment No. 1 at 18.

⁷⁴ 17 C.F.R. 240.17a-4.

⁷⁵ See CAI Letter and FSI Letter.

⁷⁶ See proposed FINRA Rule 4530.07, as modified by Amendments No. 1 and 2, which applies only if a firm has kept its records in accordance with Rule 17a-4(e)(1) of the Act.

One commenter urges the Commission to reject the rule and require FINRA to provide a detailed analysis to support its claim that the proposed rule will advance customer protection and market integrity without placing an undue burden on firms.⁷⁷ FINRA responds that the proposed rule change would enhance FINRA's ability to detect and investigate violative conduct.

One commenter argues that the current dollar thresholds in the rule that trigger a reporting obligation are too low and outdated.⁷⁸ While FINRA does not address this comment in Amendment No. 1, FINRA previously responded that it believes the current dollar thresholds in proposed FINRA Rule 4350 continue to be consistent with the purposes of the rule, and that the \$ 15,000 reporting threshold for an associated person is consistent with the Forms U4 and U5 current reporting thresholds.⁷⁹

Two commenters argue that FINRA does not have the jurisdiction to require firms to report information required under the proposed rule, such as matters relating to insurance laws and commodities laws.⁸⁰ As discussed above, FINRA notes that the requirement to report insurance matters is consistent with other provisions of the current rules and that this information is relevant to FINRA's programs as it assists FINRA in identifying members and associated persons that may pose a regulatory risk.⁸¹

IV. Discussion and Commission Findings

After carefully reviewing the proposed rule change, the comment letters, and FINRA's response, the Commission finds that the proposed rule change is consistent with the requirements

⁷⁷ See PFS Letter.

⁷⁸ See FSI Letter.

⁷⁹ See Notice, supra note 3, 75 FR at 47867.

⁸⁰ See CAI Letter and FSI Letter.

⁸¹ See supra notes 32-33 and accompanying text.

of the Act and the rules and regulations thereunder that are applicable to a national securities association.⁸² In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,⁸³ which requires, among other things, that FINRA's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The proposed rule change is consistent with FINRA's statutory obligations under the Act to protect investors and the public interest because it would enhance FINRA's ability to detect and investigate violative conduct and to identify members and associated persons of member firms that may pose a regulatory risk. The proposed rule change streamlines the rules governing reporting requirements in NASD Rule 3070 and Incorporated NYSE Rule 351 while maintaining the disclosure requirements in Incorporated NYSE Rule 351(a)(1) relating to internal conclusions.

The Commission believes that the changes made in Amendments No. 1 and 2 should provide greater clarity to members regarding when a reporting requirement arises pursuant to proposed FINRA Rule 4350 and the types of external findings, internal conclusions and customer complaints that must be reported. The Commission believes the proposed rule further strengthens FINRA's ability to effectively detect violative conduct by members and associated persons and protect investors. Further, as the proposed rule change consolidates the NYSE and NASD reporting requirement rules into one rule in the Consolidated FINRA Rulebook, it should simplify reporting requirements for broker-dealers and their associated persons.

⁸² In approving this proposed rule change, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁸³ 15 U.S.C. 78q-3(b)(6).

V. Accelerated Approval

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,⁸⁴ for approving the proposed rule change, as amended, prior to the 30th day after publication of Amendments No. 1 and 2 in the Federal Register. The changes proposed in Amendments No. 1 and 2 respond to specific concerns raised by commenters and do not raise additional issues. The rule change should enhance FINRA's ability to oversee the conduct of its members and their associated persons, which should further investor protection and the public interest. Accordingly, the Commission finds that good cause exists to approve the proposal, as modified by Amendments No.1 and 2, on an accelerated basis.

VI. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether Amendments No. 1 and 2 to the proposed rule change are consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2010-039 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2010-034. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

⁸⁴ 15 U.S.C. 78s(b)(2).

comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filings also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2010-034 and should be submitted on or before [insert 21 days from publication in the Federal Register].

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁸⁵ that the

⁸⁵ 15 U.S.C. 78s(b)(2).

proposed rule change (SR-FINRA-2010-034), as modified by Amendments No. 1 and 2, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁸⁶

Florence E. Harmon
Deputy Secretary

⁸⁶ 17 CFR 200.30-3(a)(12).