SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63331; File No. SR-FINRA-2010-059)

November 17, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 4360 (Fidelity Bonds) in the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1)[1] of the Securities Exchange Act of 1934 ("Act" or "Exchange Act")[2] and Rule 19b-4 thereunder,[3] notice is hereby given that on November 10, 2010, Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt NASD Rule 3020 (Fidelity Bonds) with certain changes into the consolidated FINRA rulebook as FINRA Rule 4360 (Fidelity Bonds), taking into account Incorporated NYSE Rule 319 (Fidelity Bonds) and its Interpretation.

The text of the proposed rule change is available on FINRA's website at http://www.finra.org, at the principal office of FINRA and at the Commission's Public Reference Room.

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1 15 U.S.C.78s(b)(1).

2 15 U.S.C. 78a.

3 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

As part of the process of developing a new consolidated rulebook ("Consolidated FINRA Rulebook"),[4] FINRA is proposing to adopt NASD Rule 3020 as FINRA Rule 4360 (Fidelity Bonds), taking into account NYSE Rule 319 (and its Interpretation).[5] Proposed FINRA Rule 4360 would update and clarify the fidelity bond requirements and better reflect current industry practices. Unless otherwise noted below, the provisions in NASD Rule 3020 would transfer, subject only to non-substantive changes, as part of proposed FINRA Rule 4360.

NASD Rule 3020 and NYSE Rule 319 (and its Interpretation) generally require members to maintain minimum amounts of fidelity bond coverage for officers and employees, and that such coverage address losses incurred due to certain specified events. The purpose of a fidelity

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4 The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE ("Incorporated NYSE Rules") (together, the NASD Rules and Incorporated NYSE Rules are referred to as the "Transitional Rulebook"). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE ("Dual Members"). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see Information Notice, March 12, 2008 (Rulebook Consolidation Process).

5 For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

bond is to protect a member against certain types of losses, including, but not limited to, those caused by the malfeasance of its officers and employees, and the effect of such losses on the member's capital.

General Provision

NASD Rule 3020(a) generally provides that each member required to join the Securities Investor Protection Corporation ("SIPC") that has employees and that is not a member in good standing of one of the enumerated national securities exchanges must maintain fidelity bond coverage; NYSE Rule 319(a) generally requires member organizations doing business with the public to carry fidelity bonds. Like NASD Rule 3020, proposed FINRA Rule 4360 would require each member that is required to join SIPC to maintain blanket fidelity bond coverage with specified amounts of coverage based on the member's net capital requirement, with certain exceptions.

NASD Rule 3020(a)(1) requires members to maintain a blanket fidelity bond in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America. Under NYSE Rule 319(a), the Stockbrokers Partnership Bond and the Brokers Blanket Bond approved by the NYSE are the only bond forms that may be used by a member organization; NYSE approval is required for any variation from such forms. Proposed FINRA Rule 4360 would require members to maintain fidelity bond coverage that provides for per loss coverage without an aggregate limit of liability. Members may apply for this level of coverage with any product that meets these requirements, including the Securities Dealer Blanket Bond ("SDBB") or a properly endorsed Financial Institution Form 14 Bond ("Form 14").[6]

[6] Since 1982, firms electing to acquire coverage through the FINRA-sponsored Insurance Program ("Sponsored Program") have been provided with the SDBB. It is the "default" insurance for FINRA members in that when a firm completes the application for the Sponsored Program, they are applying for the SDBB.

Most fidelity bonds contain a definition of the term "loss" (or "single loss"), for purposes of the bond, which generally includes all covered losses resulting from any one act or a series of related acts. A payment by an insurer for covered losses attributed to a "single loss" does not reduce a member's coverage amount for losses attributed to other, separate acts. A fidelity bond with an aggregate limit of liability caps a member's coverage during the bond period at a certain amount if a loss (or losses) meets this aggregate threshold. FINRA believes that per loss coverage without an aggregate limit of liability provides firms with the most beneficial coverage since the bond amount cannot be exhausted by one or more covered losses, so it will be available for future losses during the bond period.

Under proposed FINRA Rule 4360, a member's fidelity bond must provide against loss and have Insuring Agreements covering at least the following: fidelity, on premises, in transit, forgery and alteration, securities and counterfeit currency. The proposed rule change modifies the descriptive headings for these Insuring Agreements, in part, from NASD Rule 3020(a)(1) and NYSE Rule 319(d) to align them with the headings in the current bond forms available to broker-dealers. FINRA has been advised by insurance industry representatives that the proposed rule change does not substantively change what is required to be covered by the bond.[7]

In addition, proposed FINRA Rule 4360 would eliminate the specific coverage provisions in NASD Rule 3020(a)(4) and (a)(5), and NYSE Rule 319(d)(ii)(B) and (C), and (e)(ii)(B) and (C), that permit less than 100 percent of coverage for certain Insuring Agreements (i.e., fraudulent trading and securities forgery) to require that coverage for all Insuring Agreements be equal to 100 percent of the firm's minimum required bond coverage. Members may elect to

[7] For example, previous versions of the SDBB and Form 14 included a separate Insuring Agreement for misplacement; however, in the current versions of the bonds, this coverage is included in both "on premises" and "in transit" coverage.

carry additional, optional Insuring Agreements not required by proposed FINRA Rule 4360 for an amount less than 100 percent of the minimum required bond coverage.

Like NASD Rule 3020(a)(1)(H) and NYSE Rule 319.12, proposed FINRA Rule 4360 would require that a member's fidelity bond include a cancellation rider providing that the insurer will use its best efforts to promptly notify FINRA in the event the bond is cancelled, terminated or "substantially modified." Also, the proposed rule change would adopt the definition of "substantially modified" in NYSE Rule 319 and would incorporate NYSE Rule 319.12's standard that a firm must immediately advise FINRA in writing if its fidelity bond is cancelled, terminated or substantially modified.[8]

FINRA is proposing to add supplementary material to proposed FINRA Rule 4360 that would require members that do not qualify for a bond with per loss coverage without an aggregate limit of liability to secure alternative coverage. Specifically, a member that does not qualify for blanket fidelity bond coverage as required by proposed FINRA Rule 4360(a)(3) would be required to maintain substantially similar fidelity bond coverage in compliance with all other provisions of the proposed rule, provided that the member maintains written correspondence from two insurance providers stating that the member does not qualify for the coverage required by proposed FINRA Rule 4360(a)(3). The member would be required to retain such correspondence for the period specified by Exchange Act Rule 17a-4(b)(4). FINRA has been advised by insurance industry representatives that the proposed alternative coverage requirement is necessary for firms that, for example, have had a covered loss paid by an insurer

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[8] NYSE Rule 319 defines the term "substantially modified" as any change in the type or amount of fidelity bonding coverage, or in the exclusions to which the bond is subject, or any other change in the bond such that it no longer complies with the requirements of the rule.

within the past five years or firms that may present certain risk factors that would prevent an insurer from offering per loss coverage without an aggregate limit of liability.

Minimum Required Coverage

NASD Rule 3020 requires fidelity bond coverage for officers and employees of a member. Under NASD Rule 3020(e), the term "employee" or "employees" means any person or persons associated with a member firm (as defined in Article I, paragraph (rr) of the FINRA By-Laws) except: (1) sole proprietors, (2) sole stockholders and (3) directors or trustees of a member who are not performing acts coming within the scope of the usual duties of an officer or employee. Under NYSE Rule 319(a), any member organization doing business with the public must maintain fidelity bond coverage for general partners or officers and its employees.[9]

Proposed FINRA Rule 4360, similar to NASD Rule 3020 and NYSE Rule 319, would require each member to maintain, at a minimum, fidelity bond coverage for any person associated with the member, except directors or trustees of a member who are not performing acts within the scope of the usual duties of an officer or employee. As further detailed below, the proposed rule change would eliminate the exemption in NASD Rule 3020 for sole stockholders and sole proprietors.

The proposed rule change would increase the minimum required fidelity bond coverage for members, while continuing to base the coverage on a member's net capital requirement. To that end, proposed FINRA Rule 4360 would require a member with a net capital requirement that

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[9] Under NYSE Rule Interpretation 319/02 (Additional Coverages), the required coverage of the Brokers Blanket Bond must apply, through rider or otherwise, as applicable to: all domestic and foreign guaranteed and non-guaranteed affiliates, subsidiaries and branches; bearer instruments if the member organization handles such securities; limited partners of a member firm if they are also employees; and the partners, officers and employees or person acting in a similar capacity of electronic data processing agencies in their activities on behalf of the member organizations.

is less than $250,000 to maintain minimum coverage of the greater of 120 percent of the firm's required net capital under Exchange Act Rule 15c3-1 or $100,000. The increase to $100,000 would modify the present minimum requirement of $25,000. FINRA believes this increase is warranted since the NASD and NYSE fidelity bond rules have not been materially modified since their adoption - over 30 years ago - and $25,000 in 1974 (the year the NASD rule was adopted) is equal to approximately $110,000 today (adjusted for inflation). Although members may experience a slight increase in costs for their premiums under the proposed rule change, FINRA believes that the proposed amendments to the fidelity bond minimum requirements are necessary to provide meaningful and practical coverage for losses covered by the bond.

Under proposed FINRA Rule 4360, members with a net capital requirement of at least $250,000 would use a table in the rule to determine their minimum fidelity bond coverage requirement. The table is a modified version of the tables in NASD Rule 3020(a)(3) and NYSE Rule 319(e)(i). The identical NASD and NYSE requirements for members that have a minimum net capital requirement that exceeds $1 million would be retained in proposed FINRA Rule 4360; however, the proposed rule would adopt the higher requirements in NYSE Rule 319(e)(i) for a member with a net capital requirement of at least $250,000, but less than $1 million.[10]

Under the proposed rule, the entire amount of a member's minimum required coverage must be available for covered losses and may not be eroded by the costs an insurer may incur if it chooses to defend a claim. Specifically, any defense costs for covered losses must be in addition to a member's minimum coverage requirements. A member may include defense costs as part of

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[10] For example, NASD Rule 3020 requires a small clearing and carrying firm (i.e., one subject to a $250,000 net capital requirement) to obtain $300,000 in coverage. The same firm, had it been designated to NYSE, would have needed $600,000 in coverage. FINRA believes the increased coverage requirements are appropriate given the larger number/amount of claims that can be satisfied at these levels.

its fidelity bond coverage, but only to the extent that it does not reduce a member's minimum required coverage under the proposed rule.

Deductible Provision

Under NASD Rule 3020(b), a deductible provision may be included in a member's bond of up to $5,000 or 10 percent of the member's minimum insurance requirement, whichever is greater. If a member desires to maintain coverage in excess of the minimum insurance requirement, then a deductible provision may be included in the bond of up to $5,000 or 10 percent of the amount of blanket coverage provided in the bond purchased, whichever is greater. The excess of any such deductible amount over the maximum permissible deductible amount based on the member's minimum required coverage must be deducted from the member's net worth in the calculation of the member's net capital for purposes of Exchange Act Rule 15c3-1. Where the member is a subsidiary of another member, the excess may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

Under NYSE Rule 319(b), each member organization may self-insure to the extent of $10,000 or 10 percent of its minimum insurance requirement as fixed by the NYSE, whichever is greater, for each type of coverage required by the rule. Self-insurance in amounts exceeding the above maximum may be permitted by the NYSE provided the member or member organization certifies to the satisfaction of the NYSE that it is unable to obtain greater bonding coverage, and agrees to reduce its self-insurance so as to comply with the above stated limits as soon as possible, and appropriate charges to capital are made pursuant to Exchange Act Rule 15c3-1. This provision also contains identical language to the NASD rule regarding net worth deductions for subsidiaries.

Proposed FINRA Rule 4360 would provide for an allowable deductible amount of up to 25 percent of the fidelity bond coverage purchased by a member. Any deductible amount elected by the firm that is greater than 10 percent of the coverage purchased by the member[11] would be deducted from the member's net worth in the calculation of its net capital for purposes of Exchange Act Rule 15c3-1.[12] Like the NASD and NYSE rules, if the member is a subsidiary of another FINRA member, this amount may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

Annual Review of Coverage

Consistent with NASD Rule 3020(c) and NYSE Rule 319.10, proposed FINRA Rule 4360 would require a member (including a firm that signs a multi-year insurance policy), annually as of the yearly anniversary date of the issuance of the fidelity bond, to review the adequacy of its fidelity bond coverage and make any required adjustments to its coverage, as set forth in the proposed rule. Under proposed FINRA Rule 4360(d), a member's highest net capital requirement during the preceding 12-month period, based on the applicable method of computing net capital (dollar minimum, aggregate indebtedness or alternative standard), would be used as the basis for determining the member's minimum required fidelity bond coverage for the succeeding 12-month period. The "preceding 12-month period" includes the 12-month period that ends 60 days before the yearly anniversary date of a member's fidelity bond. This would give a firm time to determine its required fidelity bond coverage by the anniversary date of the bond.

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11 FINRA notes that a member may elect, subject to availability, a deductible of less than 10 percent of the coverage purchased.

12 NASD Rule 3020 bases the deduction from net worth for an excess deductible on a firm's minimum required coverage, while proposed FINRA Rule 4360 would base such deduction from net worth on coverage purchased by the member.

Similar to NASD Rule 3020(c)(2), proposed FINRA Rule 4360 would allow a member that has only been in business for one year and elected the aggregate indebtedness ratio for calculating its net capital requirement to use, solely for the purpose of determining the adequacy of its fidelity bond coverage for its second year, the 15 to 1 ratio of aggregate indebtedness to net capital in lieu of the 8 to 1 ratio (required for broker-dealers in their first year of business) to calculate its net capital requirement. Notwithstanding the above, such member would not be permitted to carry less minimum fidelity bond coverage in its second year than it carried in its first year.

Exemptions

Based in part on NASD Rule 3020(a), proposed FINRA Rule 4360 would exempt from the fidelity bond requirements members in good standing with a national securities exchange that maintain a fidelity bond subject to the requirements of such exchange that are equal to or greater than the requirements set forth in the proposed rule.[13] Additionally, consistent with NYSE Rule Interpretation 319/01, proposed FINRA Rule 4360 would continue to exempt from the fidelity bond requirements any firm that acts solely as a Designated Market Maker ("DMM"),[14] floor broker or registered floor trader and does not conduct business with the public.

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13 In general, the notification provisions of the corresponding exchange rules (i.e., cancellation rider and notification upon cancellation, termination or substantial modification of the bond) require notification to the respective exchange rather than to FINRA. Accordingly, the practical effect for a firm that avails itself of the proposed exemption is that such firm must maintain a fidelity bond subject to the same or greater requirements as in proposed FINRA Rule 4360; however, such firm would be exempt from the requirement that FINRA be notified of changes to the bond and would alternatively comply with the notification provisions of the respective exchange.

14 See Securities Exchange Act Release No. 58845 (October 24, 2008), 73 FR 64379 (October 29, 2008) (Order Approving File No. SR-NYSE-2008-46). In this rule filing, the role of the specialist was altered in certain respects and the term "specialist" was replaced with the term "Designated Market Maker."

Proposed FINRA Rule 4360 would not maintain the exemption in NASD Rule 3020(e) for a one-person firm.[15] Historically, a sole proprietor or sole stockholder member was excluded from the fidelity bond requirements based upon the assumption that such firms were one-person shops and, therefore, could not obtain coverage for their own acts. FINRA has determined that sole proprietors and sole stockholder firms can and often do acquire fidelity bond coverage, even though it is currently not required, since all claims (irrespective of firm size) are likely to be paid or denied on a facts-and-circumstances basis. Also, certain coverage areas of the fidelity bond benefit a one-person shop (e.g., those covering customer property lost in transit).

FINRA understands that changes to a firm's fidelity bond policy, in coordination with insurance providers, may be impacted by bond renewal cycles and changes required by the insurance industry. FINRA will consider such factors in establishing an implementation date for the proposed rule change upon approval by the SEC.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date will be no later than 365 days following Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[16] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable

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15 A one-person member (that is, a firm owned by a sole proprietor or stockholder that has no other associated persons, registered or unregistered) has no "employees" for purposes of NASD Rule 3020, and therefore such a firm currently is not subject to the fidelity bonding requirements. Conversely, a firm owned by a sole proprietor or stockholder that has other associated persons has "employees" for purposes of NASD Rule 3020, and currently is, and will continue to be, subject to the fidelity bonding requirements.

16 15 U.S.C. 78o–3(b)(6).

principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will update and clarify the requirements governing fidelity bonds for adoption as FINRA Rule 4360 in the Consolidated FINRA Rulebook.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

In July 2009, FINRA published Regulatory Notice 09-44 (FINRA Requests Comment on Proposed Consolidated FINRA Rule Governing Fidelity Bonds) requesting comment on the proposed rule change. The comment period expired on September 14, 2009. Thirteen comment letters were received in response to the Regulatory Notice. A copy of the Regulatory Notice is attached as Exhibit 2a to this rule filing. A list of the commenters, and copies of the comment letters, are attached as Exhibit 2b to this rule filing.[17]

As originally proposed in Regulatory Notice 09-44, FINRA Rule 4360 provided that any member that is required to be a member of SIPC must maintain fidelity bond coverage with the SDBB, unless they are unable to obtain this coverage, in which case they may use the Form 14. Several commenters noted that only a limited number of insurance carriers offer the SDBB, the standard form of which provides per loss (i.e., per event) coverage without an aggregate limit of liability, and requested that FINRA provide flexibility with respect to bond forms under the proposed rule.[18] These commenters suggested that limiting the bond form requirement to the SDBB restricts competition among insurance carriers, limits the potential of broker-dealers to

[17] All references to commenters under this Item are to the commenters as listed and defined in Exhibit 2b.

[18] FFS, Gallagher, HBHA, ISO, Kwiecinski, SFAA and Travelers.

secure superior coverage at more favorable terms and is likely to result in unfair pricing of such policies, raising costs for firms. The commenters further noted that the proposal creates an uneven playing field in that it promotes certain underwriters and products to the disadvantage of others that offer commensurate coverage, such as a properly endorsed Form 14. One commenter suggested that FINRA amend the proposed rule to set forth the parameters of the preferred bond form instead of prescribing a particular product.[19]

Many commenters noted that an aggregate limit of liability is standard in the industry and important to most underwriters because it quantifies and controls the underwriter's maximum exposure to loss during the bond period.[20] Further, the commenters noted that without an aggregate limit of liability, members' premium costs are likely to increase. Certain commenters believe that a bond with a "restoration of the aggregate" option is the equivalent of "per event" coverage.[21]

In response to the comments, FINRA made certain changes to the original proposal. Specifically, FINRA has amended the proposed rule to remove the requirement that a member maintain fidelity bond coverage with the SDBB, and alternatively with the Form 14. As detailed in the Purpose section of this rule filing, the proposed rule would require a member to maintain blanket fidelity bond coverage with a bond that would provide for per loss coverage without an aggregate limit of liability (e.g., the SDBB or a properly endorsed Form 14). FINRA believes the amendments to the proposal address the issues noted by the commenters while maintaining the aims of the proposed rule to provide blanket per loss fidelity bond coverage unrestricted by an aggregate limit of liability. As noted in detail in the Purpose section of this rule filing,

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19 SFAA.

20 FFS, Kwiecinski, SFAA and Travelers.

21 Kwiecinski and SFAA.

FINRA believes that a member's fidelity bond coverage should not include an aggregate limit of liability because it is important that a member's coverage not be eroded by covered losses within the bond period, thus exposing a member to future losses with a reduced bond limit.

Additionally, FINRA has amended its original proposal for alternative coverage in the supplementary material to the proposed rule to provide that a member that does not qualify for blanket fidelity bond coverage as required by proposed FINRA Rule 4360(a)(3) must maintain substantially similar fidelity bond coverage in compliance with all other provisions of the proposed rule, provided that the member maintains written correspondence from two insurance providers stating that the member does not qualify for the coverage required by proposed FINRA Rule 4360(a)(3). The member would be required to retain such correspondence for the period specified by Exchange Act Rule 17a-4(b)(4).

One commenter agreed with FINRA's proposal to increase the minimum bond limit requirement because losses often exceed the current minimum bond requirements, which exposes firms' net capital and, in some cases, results in a SIPC liquidation proceeding.[22] Other commenters noted that the proposed increased minimum requirements remain inadequate.[23] According to one commenter, the proposed minimum fidelity bond requirements do not meet comparable limits of liability set for any other insurable exposure in the commercial marketplace and, when registered representatives steal from clients, the losses frequently range from $250,000 to $5 million or more.[24]

Certain other commenters opposed the increase in the minimum bond requirement arguing that it will have a disproportionately negative effect on small firms, including small

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22 Travelers.

23 First Asset and Gallagher.

24 Gallagher.

firms that engage in certain business areas that require a higher net capital amount.[25] Two commenters requested that FINRA provide specific data to justify why the increased minimum fidelity bond requirements are necessary.[26] One commenter suggested that the expansion of the definition of "branch office" will increase fees for securing fidelity bond coverage.[27]

FINRA does not propose to make any changes to the proposed minimum requirements set forth in Regulatory Notice 09-44. As stated above in the Purpose section of this rule filing, FINRA believes the increase in the minimum fidelity bond requirements is warranted since the NASD and NYSE fidelity bond rules have not been materially modified since their adoption over 30 years ago; members that have maintained minimum coverage of $25,000 have had claims that exceed this amount; and notwithstanding a slight increase in premium costs for certain members under the proposed rule change, the proposed amendments are necessary to provide meaningful and practical coverage for losses covered by the bond. With respect to the comment regarding the "branch office" definition, FINRA notes that the proposed fidelity bond rule does not implicate the definition of "branch office." Irrespective of FINRA's definition of "branch office," the insurance provider makes the determination as to whether the number of branch offices associated with a member is a relevant criterion in assessing a member's fidelity bond coverage and premiums. FINRA neither imposes a requirement that insurance providers use branch offices as a factor in evaluating a member's qualifications to obtain fidelity bond coverage nor does it require them to use its current definition of branch office to make this determination.

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25 FGS, First Asset, HBHA and PCI.

26 First Asset and Schriner.

27 First Asset.

One commenter suggested that the proposed rule require notification to FINRA in the event that the member has experienced a loss or losses that have exhausted its fidelity bond coverage.[28] FINRA did not make any changes to the proposal in this respect because a bond without an aggregate limit of liability by its terms cannot be exhausted.

Two commenters suggested that FINRA incorporate an exemption into the proposed rule for firms that are a subsidiary of a larger parent organization.[29] According to the commenters, parent organizations of members typically purchase their own fidelity bonds, include the member subsidiary as an insured under that program, and provide substantially greater coverage than the minimum requirements under the proposed rule. Moreover, the commenters believe that the premiums paid for the FINRA bond are an unnecessary expense since the coverage already exists. The commenters also noted that, in many cases, a duplication of coverage complicates loss settlements where the bonds of both the member firm and its parent organization are affected by a single loss.

FINRA notes that neither the current fidelity bond rule nor the proposed fidelity bond rule precludes a member from being part of its parent organization's fidelity bond coverage as long as the coverage under the parent's bond provides equal to or greater coverage than the member's minimum required coverage under the rule. The parent organization's bond must contain a rider that provides for the subsidiary broker-dealer's coverage by enumerating the requirements of the FINRA rule and providing for, at a minimum, the subsidiary's minimum required coverage. Accordingly, FINRA does not propose to amend the proposed rule in this respect as it is unnecessary.

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28 Kwiecinski.

29 Kwiecinski and Travelers.

Two commenters urged FINRA to maintain an exemption from the fidelity bond requirements for one-person firms.[30] The commenters noted that FINRA could be requiring coverage that is not available in the marketplace, since the alter ego concept applies to fidelity bond claims for these entities.

As noted above in the Purpose section of this rule filing, many one-person firms currently maintain fidelity bond coverage notwithstanding the exemption in NASD Rule 3020, and claims are likely to be paid based on a facts-and-circumstances analysis, not on a firm's size or structure. As such, FINRA is not proposing any changes to the original proposal in this respect.

One commenter noted that the proposed rule serves no purpose to investors of the financial markets in its application to small firms that do not hold customer funds, execute transactions in securities on public markets, or engage in trading or underwriting (e.g., a firm that solely provides corporate financial advisory services for fee income).[31]

FINRA believes that all members of SIPC should maintain fidelity bond coverage. FINRA does not agree with the commenter's assessment, since any firm could be the target of malfeasance of one of its employees. Thus, FINRA is not proposing to incorporate an exemption for these small firms.

One commenter encouraged FINRA to incorporate a requirement for an insuring agreement for Computer Theft.[32] FINRA did not amend the proposal to add this insuring agreement at this time; however, FINRA understands that this coverage is already included in most basic riders obtained by members at no extra cost, so a member will likely obtain this coverage automatically as part of its fidelity bond coverage.

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30 SFAA and Travelers.

31 Akin Bay.

32 Travelers.

One commenter supported increased deductible thresholds; however, the commenter suggested deleting the haircut provision because the proposed rule may discourage a firm from pursuing or accepting higher deductibles if it has to take a haircut in its net capital computation for deductibles over 10 percent.[33] Another commenter suggested that the annual review requirement is duplicitous and unnecessary and that the proposed rule should speak solely to minimum bond requirements for members.[34] The commenter noted that fidelity bond reviews should be triggered by changes in a firm's net capital requirement and not subject to an annual requirement, since the firm would likely review how any changes in net capital affect all aspects of the firm when such changes occur. FINRA did not make any amendments to the proposal in these areas as these concepts have not been substantively amended from the legacy NASD rule, and FINRA believes that they are achieving their intended purposes.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

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33 Travelers.

34 IBI.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is 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-2010-059 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-2010-059. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (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 10:00 a.m. and 3:00 p.m. Copies of the filing will also 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 publicly available. All submissions should refer to File Number SR-FINRA-2010-059 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[35]

Florence E. Harmon

Deputy Secretary

[35] 17 CFR 200.30-3(a)(12).