

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-58244; File No. SR-FINRA-2008-029)

July 29, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change as Modified by Amendment No. 1 Thereto to Repeal NASD Rule 1130 and Incorporated NYSE Rules 405A, 440F, 440G and 477 as Part of the Process of Developing the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 16, 2008, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. On July 15, 2008, FINRA filed Amendment No. 1 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

FINRA proposes a rule change to repeal NASD Rule 1130 (Reliance on Current Membership List) and incorporated NYSE Rules 405A (Non-Managed Fee-Based Account Programs – Disclosure and Monitoring), 440F (Public Short Sale Transactions Effected on the Exchange), 440G (Transactions in Stocks and Warrants for the Accounts of Members, Allied Members and Member Organizations) and 477 (Retention of Jurisdiction – Failure to Cooperate) as part of the process of developing the consolidated FINRA rulebook. The text of the proposed

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

rule change is available at FINRA, the Commission’s Public Reference Room, and [www.finra.org](http://www.finra.org).

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

Background

As part of the process of developing the new consolidated rulebook (“Consolidated FINRA Rulebook”),<sup>3</sup> FINRA is proposing a rule change to repeal NASD Rule 1130 (Reliance on Current Membership List) and incorporated NYSE Rules 405A (Non-Managed Fee-Based Account Programs – Disclosure and Monitoring), 440F (Public Short Sale Transactions Effected on the Exchange), 440G (Transactions in Stocks and Warrants for the Accounts of Members, Allied Members and Member Organizations) and 477 (Retention of Jurisdiction – Failure to

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<sup>3</sup> The current FINRA rulebook consists of two sets of rules: (1) NASD Rules and (2) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together referred to as the “Transitional Rulebook”). The Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). Dual Members also must comply with NASD Rules. For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (“Rulebook Consolidation Process”).

Cooperate) to eliminate duplicative provisions and remove requirements that are specific to the NYSE marketplace.

#### Proposal

##### NASD Rule 1130 (Reliance on Current Membership List)

The proposed rule change would repeal NASD Rule 1130, which provides that the Secretary of FINRA shall furnish every member a list of all members of FINRA, and shall currently keep every member advised, by amendments to the list or otherwise, of all new members and of all suspensions and cancellations of membership. The rule also requires that each member provide such information to its offices and associated persons as appropriate, and entitles members to rely on the information provided by FINRA for the purpose of complying with the rules.

FINRA is proposing to repeal NASD Rule 1130 because the requirement to furnish a membership list is substantially similar to provisions in Article IV, Section 4 of the FINRA By-Laws, which require the Secretary of FINRA to keep a currently accurate and complete membership roll, which shall at all times be available to all members, governmental authorities and the general public.<sup>4</sup>

##### NYSE Rule 405A (Non-Managed Fee-Based Account Programs – Disclosure and Monitoring)

The proposed rule change would repeal Incorporated NYSE Rule 405A, which prescribes certain requirements in connection with placing a customer in a fee-based brokerage account. Among other things, the rule requires a member to provide the customer, in advance of opening such an account, a detailed disclosure document that must include, at a minimum: a description

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<sup>4</sup> Additionally, information about membership suspensions and cancellations is available to firms and the public through BrokerCheck and announced to members in a monthly report of disciplinary actions.

of the services provided, eligible assets, fees charged, an explanation of how costs will be computed and/or the provision of cost estimates based on hypothetical portfolios, any conditions or restrictions imposed and a summary of the program's advantages and disadvantages. The rule also requires that the member make a determination that the program is appropriate for the customer, as well as ongoing monitoring of transactional activity by customers and procedures to follow up with customers whose account activity may be inappropriate in the context of the fee-based program.

Incorporated NYSE Rule 405A essentially codifies, in a more prescriptive fashion, guidance regarding the applicability of NASD Rule 2110 (Standards of Commercial Honor and Principles of Trade) to fee-based programs set forth in NASD Notice to Members 03-68. In general, the Notice requires members to have reasonable grounds to believe that a fee-based account is appropriate for a particular customer, taking into account the services provided, cost and customer preferences. The Notice further explains that a member must implement supervisory procedures to require a periodic review of fee-based accounts to determine whether they remain appropriate for their respective customers.

As a practical matter, these requirements may have little or no current applicability to brokerage accounts in light of a recent court holding that fee-based compensation constitutes "special compensation" that triggers the requirements of the Investment Advisers Act of 1940.<sup>5</sup> As a result of the court's decision, firms generally have converted fee-based brokerage accounts into advisory accounts or altered the compensation practices for such accounts (e.g. charging transaction-based commissions rather than a fixed fee or percentage of assets under

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<sup>5</sup> See Financial Planning Ass'n v. SEC, 375 U.S. App. D.C. 389, 482 F.3d 481 (D.C. Cir. 2007).

management). However, both the Notice and Incorporated NYSE Rule 405A are aimed at fee-based accounts that do not constitute advisory accounts.

To the extent fee-based programs may continue to exist in some form in brokerage accounts, FINRA believes the Notice provides the necessary guidance for members to conform their conduct in accordance with the just and equitable principles of trade mandated by NASD Rule 2110, and further provides firms with the flexibility to adopt policies and procedures to achieve that compliance in a manner consistent with their business structure and practices.

NYSE Rules 440F (Public Short Sale Transactions Effected on the Exchange) and 440G (Transactions in Stocks and Warrants for the Accounts of Members, Allied Members and Member Organizations)

The proposed rule change would repeal Incorporated NYSE Rules 440F and 440G. Incorporated NYSE Rule 440F requires members to report on Form SS20 round-lot short sale transactions in stocks or warrants effected on the NYSE floor for public customers. Incorporated NYSE Rule 440G requires members to report on Form 121 round-lot purchases or sales of stocks or warrants effected on the NYSE floor for members, allied members or member organizations. FINRA is proposing to repeal these rules as they are specific to the NYSE marketplace and relate solely to exchange transactions.

NYSE Rule 477 (Retention of Jurisdiction – Failure to Cooperate)

Both FINRA's By-Laws and Incorporated NYSE Rule 477 provide for retained jurisdiction over former members and associated persons for initiating disciplinary actions. Under Article IV, Section 6 and Article V, Section 4 of the FINRA By-Laws, a former member or former associated person, respectively, remains subject to the filing of a FINRA complaint for two years after termination based on conduct that commenced prior to the termination. In the case of former associated persons, the FINRA By-Laws also provide that the two-year period

recommences if an amendment to a notice of termination filed within the original two-year period discloses possible misconduct. Incorporated NYSE Rule 477 provides for retained jurisdiction over a member or a member's employee for an unspecified time if, prior to termination or within one year following termination, NYSE serves written notice on such member or person that it is making inquiry into matters that occurred prior to termination.

Under the proposed rule change, FINRA would continue to use the retention of jurisdiction provisions set forth in the FINRA By-Laws and would repeal the corresponding provisions in Incorporated NYSE Rule 477.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 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,<sup>6</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change would eliminate duplicative and unnecessary rules and advance the development of a more efficient and effective Consolidated FINRA Rulebook.

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

FINRA does not believe that the proposed rule change will impose any burden on competition 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

Written comments were neither solicited nor received.

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<sup>6</sup> 15 U.S.C. 78o-3(b)(6).

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

Within 35 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 such proposed rule change; or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

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](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2008-029 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-FINRA-2008-029. 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 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 inspection and copying 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 such filing 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-2008-029 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.<sup>7</sup>

Florence E. Harmon  
Acting Secretary

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<sup>7</sup> 17 CFR 200.30-3(a)(12).