

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58661; File No. SR-FINRA-2008-030)

September 26, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change to Adopt FINRA Rule 3130 (Annual Certification of Compliance and Supervisory Processes) in the Consolidated FINRA Rulebook

I. Introduction

On June 18, 2008, 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 proposed rule change to adopt NASD Rule 3013 (Annual Certification of Compliance and Supervisory Processes) and IM-3013 (Annual Compliance and Supervision Certification) as a FINRA rule in the consolidated FINRA rulebook (“Consolidated FINRA Rulebook”)³ without material change, and to delete the corresponding provisions in Incorporated NYSE Rule 342.30 and NYSE Rule Interpretations 311(b)(5)/04 through /05 and 342.30(d)/01 through (e)/01.⁴ The proposed rule change would renumber NASD Rule 3013 and IM-3013 as FINRA Rule 3130 in the Consolidated FINRA Rulebook. The proposed rule change was published for comment in the Federal Register on July 15, 2008.⁵

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See infra note 7 for discussion about the Consolidated FINRA Rulebook.

⁴ See infra note 7 regarding “Incorporated NYSE Rules.”

⁵ See Securities Exchange Act Release No. 358118 (July 8, 2008); 73 FR 40647 (July 15, 2008) (“notice”).

The Commission received two comment letters in response to the proposed rule change.⁶ This order approves the proposed rule change.

II. Description of the Proposed Rule Change

As part of the process of developing the new consolidated rulebook (the “Consolidated FINRA Rulebook”),⁷ FINRA proposed to adopt NASD Rule 3013 (Annual Certification of Compliance and Supervisory Processes) and IM-3013 (Annual Compliance and Supervision Certification) as a FINRA rule without material change and, delete the corresponding provisions in Incorporated NYSE Rule 342.30 and NYSE Rule Interpretations 311(b)(5)/04 through /05 and 342.30(d)/01 through (e)/01. The proposed rule change would renumber NASD Rule 3013 and IM-3013 as FINRA Rule 3130 in the Consolidated FINRA Rulebook.

Currently, NASD Rule 3013 and Incorporated NYSE Rule 342 require each member to designate one or more principals to serve as a chief compliance officer (“CCO”). These Rules further require that the chief executive officer(s) (“CEO”) certify annually that the member has in place processes to establish, maintain, review, modify and test policies and procedures reasonably designed to achieve compliance with applicable NASD (or NYSE) rules and federal securities laws and regulations. The certification includes not only a statement that the member

⁶ See letters from Amal Aly, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (“SIFMA”) to Florence Harmon, Acting Secretary, Commission, dated August 4, 2008 (“SIFMA Letter”), and letter from Christine LaBastille, Managing Director, Integrated Management Solutions (“IMS”) to Secretary, Commission, dated August 5, 2008 (“IMS Letter”).

⁷ 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).

has in place certain compliance processes, but also that the CEO(s) has conducted one or more meetings with the CCO(s) in the preceding 12 months to discuss the processes. Incorporated NYSE Rule 342 and NASD IM-3013 explain that the mandated meetings between the CEO(s) and CCO(s) must include a discussion of the member's compliance efforts to date and identify and address significant compliance problems and plans for emerging business areas. NASD IM-3013 contains additional guidance, including setting forth the expertise that is expected of a CCO. The same expertise requirements are also found in Incorporated NYSE Rule Interpretation 342.30.

There currently are four differences between the NASD and NYSE rules. First, NASD IM-3013 requires that the member provide to its board of directors and audit committees (or equivalent bodies) the report that evidences the processes to which the CEO(s) certifies either prior to execution of the certification or at the earlier of their next scheduled meetings or within 45 days of certification. The Incorporated NYSE rules require submission of the report to those bodies prior to certification. FINRA does not intend to require the board of directors or audit committee to review or consider the report as a condition to the CEO executing the certification; rather, FINRA intends the provision to ensure that those governing bodies remain informed of this aspect of the member's compliance system in the context of their overall responsibility for governance and internal controls of the member for which they serve. Accordingly, the proposed rule change would maintain the NASD rule requirements.

Second, the current rules differ in the certification deadline. Incorporated NYSE Rule 342.30 requires certification as part of the submission of a member's annual compliance report, which is due by April 1 of each year. NASD Rule 3013 requires certification not later than the anniversary of the prior year's certification. And while NASD allowed members to execute their

first certification no later than April 1, 2006, to accommodate Dual Members, many FINRA-only firms executed their first certification earlier than that and thus have differing anniversary dates. Moreover, new members are required to execute their first certification within a year of approval for membership; therefore some firms necessarily are on a cycle that does not correspond to April 1. The proposed rule change would maintain the NASD rule deadline to provide firms the flexibility to certify on a schedule that meets with their organizational structure and procedures. Firms that have certified on April 1 of each year could continue to do so on that date.

Third, Incorporated NYSE Rule 342.30 requires that the member submit its certification to the Exchange, whereas the NASD rule requires only that the certification be maintained for inspection. FINRA believes the submission of the certification creates an unnecessary – albeit small – additional burden on members with no attendant benefits to FINRA’s examination program. Therefore, the proposed rule change would retain the NASD requirement that the certifications be kept for inspection by members.

Finally, while both rules permit designation of multiple CCOs subject to certain conditions, Incorporated NYSE Rule Interpretation 311(b)(5) requires Exchange approval of the allocation of supervisory responsibilities between those CCOs. By comparison, the NASD rules rely on the business judgment of the member and require only that the member define and document the areas of responsibility allocated to each CCO. FINRA believes the NASD approach is more appropriate, and therefore the proposed rule change would not adopt the approval requirement into the new rule in the Consolidated FINRA Rulebook.

III. Comment Letters

The Commission received two comment letters on the proposal,⁸ to which FINRA responded to in a letter to the Commission.⁹ The first commenter generally supported the proposal but disagreed with the deletion of the April 1 certification deadline contained in Incorporated NYSE Rule 342.30.¹⁰ In this commenter's view, adopting the NASD rule requiring certification no later than on the anniversary date of the previous year's certification could make the process less predictable and potentially more cumbersome for member firms. Specifically, the commenter indicated that for larger firms, the annual deadline would "inject uncertainty as to when the entire report and process should commence each year" and that "the time period covered by the report and certification will be constantly shifting."¹¹ As an alternative, the commenter suggested either: (1) retaining the April 1 deadline of Incorporated NYSE rule 342.30 or; (2) amending the proposed rule to allow member firms to effect annual certifications no later than three weeks after the anniversary date of the previous year's certification, but in no event later than April 1.

FINRA responded that under the proposed rule change, firms that previously certified on or near April 1 may continue to do so, so long as the certification is executed no later than the anniversary of the prior year's certification.¹² Furthermore, FINRA indicated that the

⁸ See supra note 6.

⁹ See letter from Philip Shaikun, Associate Vice President and Associate General Counsel, FINRA to Florence E. Harmon, Acting Secretary, Commission, dated September 4, 2008 ("FINRA Letter").

¹⁰ SIFMA Letter.

¹¹ SIFMA Letter.

¹² FINRA Letter.

commenter's concern appears to result from the mistaken assumption that firms that are members of both FINRA and the NYSE must couple the CEO certification with the annual compliance report that is required to be submitted each year on April 1 under Incorporated NYSE Rule 342.30. FINRA stated that a firm may choose to time the process of the CEO certification so that it coincides with the Annual Compliance Report requirement, but that the proposed rule change does not compel this outcome, thus giving a firm flexibility as to when the certification process begins and ends. In addition, FINRA indicated that the commenter did not adequately consider the needs of FINRA-only firms that have chosen a cycle other than April 1 that better meets their organizational structure and procedures.¹³

The second commenter asserted that NASD Rule 3013 is unworkable and ineffectual for small FINRA member firms and urged FINRA to adopt a small firm exemption as part of the proposal.¹⁴ The commenter stated that the provision requiring the CEO and CCO to meet to discuss and review elements related to the certification is unworkable for small firms when the CEO and CCO are the same person. FINRA indicated that it expects that a person who is both CEO and CCO of a firm will contemplate the required topics of the meeting and document that he or she has reviewed those matters.¹⁵

IV. Discussion and Findings

After careful review of the proposed rule change, the comment letters and FINRA's response to the comment letters, the Commission finds that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder that are

¹³ Id.

¹⁴ IMS Letter. IMS also commented on the requirements of NASD Rule 3012, which is not part of the proposal.

¹⁵ FINRA Letter.

applicable to national securities associations,¹⁶ and in particular, Section 15A(b)(6) of the Act,¹⁷ which requires among other things, that FINRA rules 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. The Commission believes that it is reasonable for FINRA to adopt NASD Rule 3013 and IM-3013 as FINRA Rule 3130 in the Consolidated FINRA Rulebook because they have previously been found to meet statutory requirements.¹⁸

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-FINRA-2008-030) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁹

Florence E. Harmon
Acting Secretary

¹⁶ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. See 15 U.S.C. 78c(f).

¹⁷ 15 U.S.C. 78o-3(b)(6).

¹⁸ See e.g., Securities Exchange Act Release No. 53509 (March 17, 2006), 71 FR 15238 (March 27, 2006) (SR-NASD-2006-036) (order approving rule change to IM-3013 finding that the proposed change furthered investor protection goals and provided clarity regarding application of the rule); Securities Exchange Act Release No. 56285 (August 17, 2007), 72 FR 48715 (August 24, 2007) (SR-NASD-2007-049) (order approving rule change to NASD Rule 3013 and IM-3013 finding that the proposed changes decreased the likelihood of fraud and manipulative acts in addition to increasing investor protection).

¹⁹ 17 CFR 200.30-3(a)(12).