

FINRA Proposes Amendments to Reporting Requirements

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Introduction

On November 28, 2008, the Financial Industry Regulatory Authority (“FINRA”) requested comment on proposed FINRA Rule 4530 (“Proposed Rule”),¹ which would replace NASD Rule 3070 and NYSE Rule 351 with a single consolidated rule governing members’ reporting of legal violations and certain other specified events.² FINRA is seeking comments on the proposal by December 29, 2008.

Summary

The Proposed Rule is based primarily on NASD Rule 3070, but also incorporates a number of specific requirements from NYSE Rule 351. The Proposed Rule clarifies ambiguities in the current rules and contains a few significant changes for FINRA members (particularly for those that are not NYSE members), who will be subjected to several new reporting requirements. Notable aspects of the Proposed Rule include:

- » Requiring all members to report to FINRA once the member firm has internally concluded that a violation of certain specified laws, rules, regulations or standards of conduct has occurred;
- » Clarifying and modifying the types of violations by a member or associated person that give rise to reporting obligations; and
- » Establishing a consistent 30-day reporting deadline.

Reporting Internal Findings of Violations

Proposed Rule 4530(a)(3) requires all members to report violations of any securities, insurance, commodities, financial or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body, or self-regulatory organization once the firm has *internally concluded* that a violation of law or regulation by either the firm or an associated person has occurred.³ Reporting internal conclusions of violations is not currently required under NASD Rule 3070(a)(1), but FINRA takes the position that internal conclusions of a specified violation currently require reporting by NYSE member firms under NYSE Rule 351(a)(1). The Proposed Rule would apply the NYSE approach to all FINRA members. The Proposed Supplementary Materials to Rule 4530 (“Supplementary Materials”) would set a threshold for reporting internal conclusions of violations by excluding isolated violations by the member or its associated persons that can reasonably be viewed as ministerial violations that did not result in customer harm and were promptly remedied.

¹ FINRA Regulatory Notice 08-71. The proposal is part of the overall process by FINRA to create a unified rulebook that consolidates various provisions of the National Association of Securities Dealers, Inc. (“NASD”) and the New York Stock Exchange (“NYSE”) rulebooks.

² After reviewing member comments, FINRA must submit the Proposed Rule to the SEC for approval before it can put it into effect.

³ There is no longer a need to report internal conclusions of violations of business or professional organizations rules or conduct inconsistent with just and equitable principles of trade, which is currently required under NYSE Rule 351(a)(1).

Reporting Disciplinary Actions

Like the current rules, Proposed Rule 4530(a)(2) requires all members to report any disciplinary action taken by the member against associated persons that involves suspension, termination, the withholding of compensation or any remuneration in excess of \$2,500, the imposition of fines in excess of \$2,500, or any other forms of discipline that would have a significant limitation on the individual's activities.

Reporting External Findings of Violations

Proposed Rule 4530(a)(1)(A), like the current rules, requires members to report an external body's "finding" of certain specified violations. The Proposed Rule includes Supplementary Material that clarifies the meaning of "found" in a manner that is generally consistent with the definition used in Form BD and Form U-4. Under the new definition, the reporting obligation is triggered by formal findings, whether or not they will be appealed, and adverse final actions.⁴ The definition also provides a list of items excluded from the meaning of "found."⁵

Expanded and Clarified List of Reportable Regulatory Violations

The Proposed Rule expands and specifies the bodies of relevant law subject to reporting requirements if there is a violation. Proposed Rules 4530(a)(1)(A) and (a)(3) require that members report violations of any securities, insurance, commodities, financial or investment-related laws, rules, regulations, or standards of conduct of any domestic or foreign regulatory body or self-regulatory organization, and, if there has been a "finding" of a violation by an external adjudicator, of any business or professional organization. The Proposed Rule expressly includes findings by foreign regulatory bodies, including authorized non-governmental agencies like the U.K. Financial Services Authority.

Disclosure Regarding Persons Subject to Statutory Disqualification

Proposed Rule 4530(a)(1)(H) clarifies the range of associations with statutorily disqualified parties that will give rise to a reporting obligation. Under the current NASD and NYSE rules, a member must report if it is "associated in any business or financial activity" with a person subject to a "statutory disqualification." The Proposed Rule specifies that reporting is only required if the disqualified person is involved in the "sale of any financial instrument, the provision of any investment advice or the financing of any such activities."⁶

Reporting Deadline Set at 30 Calendar Days

Proposed Rule 4530(a) would require the member firm to "promptly" report to FINRA not later than 30 calendar days after the member knows or should have known about the existence of any specified event. The 30-day reporting deadline

⁴ Examples of adverse final actions include consent decrees involving no admission or denial of findings by the respondent, a Letter of Acceptance, Waiver and Consent or an Offer of Settlement.

⁵ The list includes informal agreements, deficiency letters, examination reports, memoranda of understanding, cautionary actions, admonishments and similar informal resolutions of matters or violations of self-regulatory organization rule designated as "minor" pursuant to a plan approved by the SEC, if the sanction imposed consists of a fine of \$2,500 or less, and if the sanctioned person does not contest the fine.

⁶ The Regulatory Notice implies that FINRA may seek to eliminate the current (and historically very burdensome) requirement in NYSE Rule 351(c) that notice be given to the NYSE if any "approved person" (essentially, a controlling person or person under common control with an NYSE member) becomes subject to a statutory disqualification.

is consistent with the NYSE rule, but increases the 10 business day reporting deadline provided under current NASD Rule 3070(b). The proposed “trigger” for the reporting deadline, *i.e.*, when the member knows or should have known about the specified event, is consistent with the NASD rule, but is not part of the current NYSE rule.

Other Modifications and Clarifications

The Proposed Rule and Supplementary Materials contains other minor changes and clarifications to the current rules, including:

- » **Former Associated Persons.** Events involving a formerly associated person that occurred while the individual was associated with the member must be reported.
- » **Written Customer Complaints.** Written customer complaints reported as a specified event under Proposed Rule 4530(a)(1)(B) must also be reported in the quarterly summary information regarding customer complaints under Proposed Rule 4530(c).

Conclusion

The Proposed Rule expands the scope of the reporting requirements in certain respects – particularly in regard to internal findings of violations by non-NYSE FINRA member firms – while clarifying certain ambiguities in the rules. Firms should review the proposed changes and determine whether to comment on these changes.

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If you have any questions about the matters covered in this memorandum, please contact either of the lawyers listed below or your regular Davis Polk contact:

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