

## BDQUARTERLY

“I am concerned that some participants in the private fund industry may be inappropriately claiming to rely on exemptions or interpretive guidance to avoid broker-dealer registration.”

– SEC Division of Investment Management Director **Buddy Donohue**

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### Amendments Relating to Political Contributions

On January 20, 2010, the SEC approved amendments to **Rule G-37** regarding political contributions and prohibitions on municipal securities business, and **Rule G-8** regarding books and records to be maintained by broker-dealers and municipal securities dealers.<sup>1</sup> The amendments to Rule G-37 now make it mandatory to disclose on MSRB Form G-37 certain contributions to bond ballot campaigns made by dealers, municipal finance professionals (“MFPs”), their political action committees (“PACs”), and non-MFP executive officers. The amendments to Rule G-8 will require broker-dealers to create and maintain

books and records reflecting non-de minimis contributions to bond ballot campaigns.

Rule G-37 was originally created to mitigate conflicts of interest between dealers and issuers of municipal securities. The rule prohibits dealers in municipal securities from engaging in municipal securities business with an issuer for two years after a contribution is made to an official of that issuer. The rule was also intended to prohibit dealers from soliciting or coordinating contributions to officials of issuers in which the dealer was actively engaged in municipal securities business, or actively seeking to engage in municipal securities business. The rule requires dealers to (CONTINUED)

<sup>1</sup>–See [www.msrb.org/msrb1/whatsnew/2010-01.asp](http://www.msrb.org/msrb1/whatsnew/2010-01.asp)

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publicly disclose any contributions to issuer officials and payments to political parties of states or localities where the dealer is engaging in, or seeking to engage in, municipal securities business. Rule G-8 was designed to establish books and records requirements regarding contributions and payments covered by Rule G-37.

The rule amendments enhance the required disclosure pursuant to bond ballot campaigns. Bond ballot campaigns typically occur as a result of a state or local government placing a ballot measure before voters in order to obtain approval for a specified municipal borrowing. Many state and local jurisdictions now require voter approval to issue municipal bonds to fund municipal finance

projects. It should be noted that there are no reporting requirements for contributions made by an MFP or non-MFP executive officer to a bond ballot campaign when such person is entitled to vote, so long as all contributions by such person to the bond ballot campaign do not exceed \$250 per ballot initiative.

The rule amendments became effective on February 10, 2010. Any contributions made after this date must be reported on the amended G-37 form no later than April 30, 2010. Firms should also consider updating their written supervisory procedures to reflect the new requirements.

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## New Large Options Positions Report

In June 2008, the Options Clearing Corporation (“OCC”) and their participant exchanges implemented the Option Symbology Initiative (“OSI”).<sup>2</sup> Although the reporting thresholds remain unchanged, the OSI significantly changed the submission methods and system layout for reporting Large Options Position Reports (“LOPRs”). In August 2009, FINRA summarized the key requirements and changes related to the new LOPR in [Regulatory Notice 09-47](#).

As a reminder, FINRA Rule 2360(b)(5) requires member firms to file a LOPR for each account (or accounts acting in concert) that has an aggregate position of 200 or more options contracts (whether long or short) on the same side of the market covering the same underlying security or index.

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2—The participating exchanges and SROs include: American Stock Exchange (AMEX), Boston Options Exchange (BOX), Chicago Board Options Exchange, Inc. (CBOE), International Securities Exchange (ISE), NASDAQ Options Market (NOM), NYSE Arca (NYSE), Philadelphia Stock Exchange (PHLX), and The Financial Industry Regulatory Authority (FINRA).

Accounts for which LOPRs are required pursuant to FINRA Rule 2360(b)(5)(A)(i) include those in which the broker-dealer has an interest, each account of a partner, officer, director, or employee of such broker-dealer, and each customer, non-member broker, or non-member dealer. Accordingly, if a firm enters into a transaction with a customer creating a reportable position for both the member firm and the customer, FINRA rules require a LOPR for each position to be submitted for both the customer and the broker-dealer.

Effective February 12, 2010, all exchange traded options began using explicit data elements instead of the current Options Price Reporting Authority codes,<sup>3</sup> which were limited to five characters long. Additionally, OCC took over the collection and dissemination of all LOPR data from the Securities Industry Automation Corporation (“SIAC”) on January 19, 2010. OCC is now the (CONTINUED)

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3—LOPR will be written in FIXML

central repository for “In Concert Account Data” and firms must directly file with OCC.

A link to the OCC guide for the new LOPR record layouts and explanation of fields and mapping of OCC fields to current SIAC fields can be at [http://www.optionsclearing.com/components/docs/initiatives/lopr/lopr\\_ref\\_guide.pdf](http://www.optionsclearing.com/components/docs/initiatives/lopr/lopr_ref_guide.pdf).

ACA reminds broker-dealers to revisit their operational reporting procedures for filing LOPRs. Firms should also work with their clearing firms and outside vendors to ensure that their file formats are supported and that their systems are vetted to accommodate the new OSI.

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## **FINRA Fines Broker-Dealer and CEO \$750,000**

### **for Private Placement Offering Failures**

In December 2009 FINRA fined a broker-dealer and its former CEO a combined \$750,000 for not fully disclosing complete information in private placement offering documents and marketing material.<sup>4</sup> FINRA also charged the firm and CEO with advertising violations and supervisory failures.

continued to use similar targeted time periods for return of capital and rates of return that were not supported by its past performance.

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**FINRA also found that the firm and CEO did not establish, maintain and enforce a supervisory system, including written procedures reasonably designed to review and monitor sales of the private placement offerings.**

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During this same time, the CEO sent letters to the private placement investors to update them on the progress of their investment that included positive—but unrealistic—expectations, without providing required risk disclosures of the unrealistic outcome. The letters also failed to properly reveal the state of the financial condition of the issuers of the private placements.

FINRA also found that the firm and CEO did not establish, maintain and enforce a supervisory system, including written procedures reasonably designed to review and monitor sales of the private placement offerings.

From January 2004 to May 2009, the firm provided false information to investors with unrealistic targeted returns of principal in a two to four year time period and a yield on an investment in excess of 18 percent. In addition, both the firm and CEO

In addition to paying the \$700,000 fine, the firm has agreed to provide corrective disclosures to investors and to submit advertising and sales literature to FINRA for pre-use review for one year. The CEO was fined \$50,000 and suspended in all capacities for 20 business days and in a principal capacity for an additional three months.

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<sup>4</sup>—See [www.finra.org/Newsroom/NewsReleases/2009/P120612](http://www.finra.org/Newsroom/NewsReleases/2009/P120612)

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## FINRA Proposed Membership Rule Changes 10-01

FINRA issued [Regulatory Notice 10-01](#) (“RN 10-01”) on January 4, 2010. The notice proposes the combination of the NASD membership rules into the Consolidated FINRA Rulebook.

The NASD Rule 1010 Series are the current guide to FINRA’s membership rules, which provide a way for FINRA to evaluate the proposed business activities of its potential and current member firms. This is accomplished through the Membership Application Process which encompasses New Member Applications (“NMAs”), Continuance in Membership Applications (“CMAs”), and Membership Agreement Changes (“MACs”).

The following list highlights some of the proposed changes to be included in the Consolidated FINRA Rulebook:

- Proposed Rule 1111 defines and amends the terms “Affiliate”, “Control”, “Material Change in Business Operations” and “Sales Practice Event”.
- Proposed Rule 1112 reduces the time for an applicant to respond to the initial written request by FINRA from 60 days to 30 days. Rule 1112 also states that if the exams required for

the application are not scheduled within 30 days and completed within 120 days, the NMA or CMA will lapse.

- Proposed Rule 1121 requires applicants to provide a detailed summary on their affiliate relationships.
- Proposed Rule 1130 requires all NMAs, CMAs and MAC applications to fully document all of the funding sources, and permits FINRA to determine that such sources are not objectionable.
- Proposed Rule 1160 increases from 30 days to 45 days the time frame to issue a written decision on a CMA, and requires that the reason an application was granted or denied to be stated.
- Proposed Rule 1170 requires a member firm to provide a written notice of certain significant changes in its business 30 days prior to the event’s occurrence. Once received, FINRA will determine if these changes require a CMA to be filed.

These proposed FINRA rules are a snapshot of the changes that are taking place in amending and consolidating the Membership Application Process. Full descriptions are available in RN 10-01.

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## In Case You Missed It!

### **FINRA Fines Broker-Dealers for Inadequate Anti-Money Laundering Programs, Other Violations**

FINRA has advised firms that when designing their AML programs, they should consider factors such as their size, location, business activities, the

types of accounts they maintain and the types of transactions in which their customers engage. Clearing firms are also advised to consider carrying out computerized surveillance of account activity to identify suspicious operations. (CONTINUED)

Two recent settlements with FINRA highlight the importance of proper AML supervisory controls:

- A Texas-based firm was fined \$450,000 for failing to establish and implement an adequate anti-money laundering program to detect and trigger reporting of suspicious transactions, as required by the Bank Secrecy Act, FINRA rules, and other regulations.
- A North Carolina-based firm was fined \$300,000 for failing to implement AML procedures reasonably designed to detect and cause the reporting of suspicious activity as well as to verify the identity of customers.<sup>5</sup>

#### **FINRA Changes and Examination Priorities for 2010**

FINRA has issued its annual examination priorities letter for 2010.<sup>6</sup> The letter discussed the following important issues:

##### **New developments**

FINRA created the Office of Fraud Detection and Market Intelligence. It is designed to help FINRA develop more thorough and robust reviews, including more extensive training for FINRA examiners.

FINRA is expanding BrokerCheck and making the disciplinary disclosures against registered representatives permanent in the system. These actions will now be disclosed even if the representatives leave the industry.

FINRA is also rolling out an eFOCUS Filing Platform, which is an upgraded system for firms to submit FOCUS reports electronically to FINRA.

##### **Regulatory and Business Considerations**

**Mergers and Acquired Firms** – FINRA has discovered that many of its members fail to successfully integrate and update their back-office operations and systems, and do not train their employees on new systems, subsequent to mergers and acquisitions. In addition, these firms are at risk of losing key personnel with system knowledge that is not easily replaced. FINRA indicated that it will be sanctioning firms for not having adequate protocols and procedures in place for managing mergers and acquisitions.

**Direct Market Access and Sponsored Access** – FINRA is looking at broker-dealers' controls and supervision around allowing their customers to directly access market centers. Due to recent growth in high-frequency trading, FINRA has placed more emphasis on ensuring that broker-dealers limit their exposure to financial risk when they allow their customers filtered and unfiltered access to markets. FINRA is also looking for broker-dealers to validate order accuracy and to monitor for duplication/retransmission of orders previously transmitted for execution.

**Life Settlements** – FINRA is closely reviewing the disclosures of risks related to the sale of existing life insurance policies to third parties. For example, broker-dealers must fully explain to clients the tax implications, costs, and confidentiality issues. These disclosures are especially important when life settlement products are marketed to senior citizens.

##### **2010 Examination Priorities**

The 2010 examination priorities highlighted by FINRA include:

**Fraud Detection** – FINRA expects firms to adopt robust supervisory systems that (CONTINUED)

5–See [www.finra.org/Newsroom/NewsReleases/2010/P120859](http://www.finra.org/Newsroom/NewsReleases/2010/P120859)

6–See [www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p121004.pdf](http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p121004.pdf)

are reasonably designed to detect and prevent fraudulent activities by employees, as well as controls to mitigate potential fraud by management.

Variable Annuities – Broker-dealers must address requirements for principal review and approval within supervisory procedures.

Anti-Money Laundering – AML programs must be tailored to the firm and customized to identify red flags that are likely to be encountered by employees.

Outsourcing – Firms remain responsible for any supervisory control that is outsourced.

Day Trading Margin – Certain broker-dealers have failed to comply with the requirement that customer accounts are funded with at least \$25,000.

Firms have improperly sought to use non-liquid securities for margin purposes.

Additional examination priorities for 2010 include:

- Information barriers
- Fully paid lending programs
- Short sales and regulation SHO compliance
- Algorithmic trading
- Protection of customer information and IT/cyber-security
- Pandemic preparedness
- Branch office supervision
- Inventory and collateral valuation
- Customer margin debit collateralized by non-marketable securities
- Accounting and spreadsheet controls

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## Did You Know...

### **SEC Approval and Effective Date for New Consolidated FINRA Rules; Effective Date: April 19, 2010**

The SEC has approved three new consolidated rules that will become effective April 19, 2010:

- [Rule 4570](#) (Custodian of Books and Records)
- [Rule 5160](#) (Disclosure of Price and Concessions in Selling Agreements)
- [Rule 5330](#) (Adjustment of Orders)

### **SEC Approves Amendments to FINRA Rules on Reporting Cancellations of Previously Reported OTC Trades in Equity Securities; Effective Date: April 12, 2010**

As described in Regulatory Notice 10-07,<sup>7</sup> broker-dealers are no longer prohibited from reporting trade cancellations to the FINRA / NASDAQ Trade Reporting Facility and the OTC Reporting Facility after 5:15 p.m. Eastern Time on trade date. Firms are reminded, however, that they must report the cancellation of any previously reported over-the-counter transaction in an equity security in accordance with the FINRA trade reporting rules. (CONTINUED)

7-See [www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120790.pdf](http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120790.pdf)

### **SEC Extends Regulation S-AM**

#### **Compliance Date**

The SEC has extended the compliance date for its affiliate marketing rule, [Regulation S-AM](#), from January 1, 2010 to June 1, 2010.<sup>8</sup>

### **201 CMR 17.00: Standards for the Protection of Personal Information of Residents of the Commonwealth**

On March 1, 2010, a new Massachusetts data protection law: 201 CMR 17, Standards for The Protection of Personal Information of Residents of the Commonwealth, became effective. The new regulation mandates data protection standards that must be met by all persons who own, license, store or maintain personal information about a resident of the Commonwealth of Massachusetts. This law is intended to protect against probable threats or hazards to the security or integrity of personal information. It also forbids unlawful access to or use of such information in a manner that creates a significant danger of identity theft or fraud against such residents.

Specifically, the Standards require a firm to take the following actions, among others:

- Designate one or more individuals responsible for maintaining the information security program;
- Assess information security risks on an ongoing basis;

- Terminate access to information by former employees;
- Oversee service providers;
- Place reasonable restrictions on physical records;
- Implement secure user authentication and access controls for electronic systems;
- Encrypt, where feasible, all electronically transmitted records;
- Maintain up-to-date virus definitions, firewall protections, and operating system security patches;
- Provide initial and ongoing training to employees; and
- Document the responses to information security breaches and records of corrective actions taken as a result of the breach.

### **FinCEN Expands Access to Section 314(a) Information Requests**

Effective February 10, 2010, FinCEN's final rule expanded the Section 314(a) information sharing program adopted pursuant to the Bank Secrecy Act. Foreign regulators, state regulators, and FinCEN itself now participate in the information sharing program.

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<sup>8</sup>– See [www.sec.gov/rules/final/2009/34-60946.pdf](http://www.sec.gov/rules/final/2009/34-60946.pdf)

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## Conferences/Roundtables/Webcasts

### FINRA Conferences

#### Annual Conference

May 26-28, 2010

Baltimore, MD

#### Advertising Regulation Conference

November 9-10, 2010

Washington, DC

### ACA Conferences

ACA Compliance Group

Fall Compliance Conference

September 22-24, 2010

San Diego, CA

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## Regulatory Notices, Updates, and Rule Changes

### FINRA Regulatory Notices

March

Regulatory Notice 10-15 FINRA Requirements for Subordinations; Availability of New Standard Forms

Regulatory Notice 10-14 SEC Approves Access to Historic TRACE Data and Related Fees. **Effective Date:** March 31, 2010

February

Regulatory Notice 10-13 SEC Approves Amendments to the FINRA Rule 9550 Series Governing Expedited Proceedings **Effective Date:** March 25, 2010

Regulatory Notice 10-12 Guidance on FAS 167 for FOCUS Reporting

Regulatory Notice 10-11 Amendments to the Arbitration Rules Regarding Deficient Claims. **Effective Date:** March 22, 2010

Regulatory Notice 10-10 SEC Approval and Effective Date for New Consolidated FINRA Rules. **Effective Date:** April 19, 2010

Regulatory Notice 10-09 FINRA Reminds Firms of Their Sales Practice Obligations with Reverse Exchangeable Securities (Reverse Convertibles)

Regulatory Notice 10-08 Filing Requirements for Members that Carry Customer Margin Accounts; New Customer Margin Balance Form. **Effective Date of Rule Requirements:** February 8, 2010; **Availability of New Form:** March 1, 2010

2/12/2010 Nominees for the District Committees and District Nominating Committees

2/8/2010 FINRA Extends Implementation of Amendments Requiring Related Market Center Indicator in Non-Tape Reports Submitted to FINRA. **Revised Effective Date:** May 3, 2010

January

Regulatory Notice 10-07 SEC Approves Amendments to FINRA Rules on Reporting Cancellations of Previously Reported OTC Trades in Equity Securities. **Effective Date:** April 12, 2010

Regulatory Notice 10-06 Guidance on Blogs and Social Networking Web Sites

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[Regulatory Notice 10-05](#) FINRA Reminds Firms of Their Responsibilities under FINRA Rule 2330 for Recommended Purchases or Exchanges of Deferred Variable Annuities

[Regulatory Notice 10-04](#) SEC Approves Consolidated FINRA Rules Governing Clearly Erroneous Transactions. **Effective Date:** February 15, 2010

[Regulatory Notice 10-03](#) FINRA Requests Comments on Proposed Consolidated FINRA Rules Governing Securities Loans and Borrowings, Permissible Use of Customers' Securities and Callable Securities. **Comment Period Expires:** March 8, 2010

[Regulatory Notice 10-02](#) Broker-Dealer, Investment Adviser Firm, Agent and Investment Adviser Representative, and Branch Renewals for 2010. **Payment Deadline:** February 5, 2010

[Regulatory Notice 10-01](#) Proposed Consolidated FINRA Rules Governing FINRA's Membership Application Proceedings. **Comment Period Expires:** March 5, 2010

#### **Securities and Exchange Commission**

February

[Release No. 34-61595](#) Amendments to Regulation SHO. **Effective Date:** May 10, 2010

#### **Municipal Securities Rulemaking Board**

February

[MSRB Notice 2010-03](#) Reminder of February 1, 2010 Effective Date of Amendments to Rule G-8 and Rule G-37

January

[MSRB Notice 2010-02](#) Nominating Committee Seeking Board Candidate Recommendations

[MSRB Notice 2010-01](#) SEC Approves Amendments to Rule G-37 and Rule G-8 Relating to Political Contributions

#### **Financial Crimes Enforcement Network**

Department of Justice News Release: [Financial Fraud Enforcement Task Force Hosts Mortgage Fraud Summit in Miami](#) (02/24/2010)

FinCEN Issues [Mortgage Loan Fraud Update; Warns of Foreclosure Rescue Scam Techniques](#) (02/18/2010)

FinCEN Regulation Improves [Domestic and International Information Sharing to Thwart Money Laundering and Terrorist Finance](#) (02/05/2010)

FinCEN Releases Latest Edition of [SAR Activity Review – By the Numbers](#) (01/22/2010)

## Filing Dates

### 2009-2010 Monthly/Quarterly FOCUS

#### Part II/IIA Filings

Month Ending	Due Date
March 31, 2010	April 26, 2010
April 30, 2010	May 25, 2010
May 31, 2010	June 23, 2010
June 30, 2010	July 26, 2010

#### 2010 Annual Audit Filings

Fiscal Year End	Due Date
February 28, 2010	April 29, 2010
March 31, 2010	June 1, 2010
April 30, 2010	June 29, 2010
May 31, 2010	July 30, 2010
June 30, 2010	August 30, 2010

### 2010 Customer Complaint Filings

Quarter Ending	Due Date
1st Quarter 2010	April 15, 2010
2nd Quarter 2010	July 15, 2010

### 2010 Short Interest Reporting Deadlines

Settlement	Due Date	Exchange Receipt
3/31/10	4/5/10-6PM	4/12/10
4/15/10	4/19/10-6PM	4/26/10
4/30/10	5/4/10-6PM	5/11/10
5/14/10	5/18/10-6PM	5/25/10
5/28/10	6/2/10-6PM	6/9/10
6/15/10	6/17/10-6PM	6/24/10
6/30/10	7/2/10-6PM	7/12/10

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In these uncertain times, compliance officers must closely monitor changing regulations while fulfilling their current compliance obligations. As an alternative to increasing their compliance staff, leading financial services firms choose to partner with ACA.

ACA clients benefit from the creation of customized compliance programs that meet the increasingly complex regulatory requirements. Please contact us to discuss how ACA's team of former FINRA, NYSE and SEC regulators can help you effectively manage your compliance burden.

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ACA Compliance Group **Broker-Dealer Services**  
1900 NW Corporate Blvd., Suite 200W Boca Raton, FL 33431  
561.988.3310 **PHONE** 561.988.3305 **FAX**

[www.acacompliancegroup.com](http://www.acacompliancegroup.com)