



BDQUARTERLY

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— Mary L. Shapiro, CEO of FINRA
2007 FINRA Fall Securities Conference

FINRA Fall Securities Conference Take-Aways

ACA recently attended FINRA’s Annual Fall Securities Conference, which was aimed at providing comprehensive updates on securities industry rules, regulations and compliance issues. One of the highlights of the conference was the remarks made by FINRA’s Chief Executive Officer, Mary L. Shapiro.

Shapiro’s speech was marked by references to FINRA’s integration and governance, as well as technological changes (such as the FINRA Gateway) aimed at streamlining the regulatory process.

Shapiro stated, “All of these developments hold great possibilities for the industry and investors. Yet, when I look at what’s happening in the capital markets it reminds me of that memorable first line from *A Tale of Two Cities*, by Charles Dickens: ‘It was the best of times, it was the worst of times.’” Shapiro’s speech went on to analyze this statement while addressing FINRA’s ongoing role in the market place.

The following article highlights a number of the key items discussed in these sessions.

Anti-Money Laundering (“AML”)

The anti-money laundering session was led by senior representatives from FINRA Member Regulation and Enforcement, as well as a special agent from the FBI.

The session went beyond the basic discussion concerning general AML rules and regulations and provided an in-depth analysis of how money laundering occurs, as well as several examples of suspicious types of activity. The emphasis of the FINRA presentation was to advise firms to continue to enhance overall customer identification process, since individuals engaged in money laundering activities have been evolving in their techniques and disguise capabilities. The presenters advised that suspicious activity

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monitoring should not only be focused on money movements and trading activity, but also should cover products such as broker-dealer investment accounts with credit card and check writing capabilities. The examples utilized during the discussion further emphasized the Staff's continued focus on customer identification and suspicious activities during future regulatory examinations.

Aging Investors and the Securities Industry

In a response to continued sales practice concerns related to senior investors, as well as the large number of retiring baby boomers, FINRA conducted a number of regulatory sweeps analyzing the sales practice activities of registered representatives offering free lunch seminars that were focused on retirees. In reaction to items noted during the various sweeps combined with the large aging population, FINRA has initiated efforts and examination priorities focused on protecting senior investors, culminating in FINRA's issuance of [Regulatory Notice 07-43](#) in September 2007. The purpose of the notice was to advise firms that they should review and, if necessary, enhance their firm's policies and procedures for complying with FINRA sales practice rules, as well as other applicable laws, with an emphasis on common regulatory issues related to senior investors.

Broker-Dealer and Investment Adviser Issues

This session addressed the overall changes that affected broker-dealers concerning the decision that vacated the SEC's adoption of Rule 202(a)(11) (also known as the "Merrill Rule") under the Investment Advisers Act of 1940. The panel targeted its discussion towards broker-dealers classified as "dual registrants" and other broker-dealers that employ investment advisory representatives ("IARs") who maintain an affiliation with a third party investment adviser.¹

¹ Dual registrants are entities that are registered both as broker-dealers and investment advisers.

The FIRNA staff advised that future examinations would continue to focus on the following areas:

- The overall process and documentation member firms utilized to become compliant with the vacated Merrill Rule;
- Analysis of joint books and records; and
- Supervision of IAR activities pursuant to outside business activities defined under NASD Rule 3040.

The greatest area of concern addressed by the panel was a broker-dealer's ability to adequately supervise the outside investment adviser activities of its IARs. The presenters emphasized that future examinations would continue to focus on each broker-dealer's ability to effectively document and monitor outside business activities.

In addition to the previous concern, the panel identified certain issues related to dual registrants that maintain a single set of books and records for their broker-dealers and investment advisers. Such activity is not prohibited, but it presents a number of issues concerning a clear separation of what activity is related to the investment adviser versus the broker-dealer. This can create regulatory confusion during examinations as well as jurisdiction issues.

New Products: Regulatory and Compliance Considerations

This session at the conference concentrated on the regulatory and compliance issues firms should consider when selling new products. The panel consisted of chief compliance officers from both a large broker-dealer and a relatively small regional broker-dealer, as well as the Chief Economist from FINRA.

The panel emphasized that NASD Rule 3010 requires firms that are engaged in selling new products to adopt written supervisory procedures to ensure that no new products are introduced to customers before being thoroughly reviewed from both a regulatory and business perspective. Specifically, a firm's procedures should address:

- The firm's definition (classification) of the new product;
- General questions that should be asked of customers;
- Identification of principals responsible for supervising the new product and the frequency of such review; and
- Overall process for supervisory reviews and documentation, including any recommended action.

One of the most interesting items noted by the panel was that regardless of the number of registered individuals supervised by a firm, the firm should consider establishing a "New Products Committee." Typical committees usually establish a review process, often involving legal and compliance personnel, in the early stages of product development.

It will require vigilance by regulators and industry alike — we are partners in investor protection. —Mary L. Shapiro

Another consideration that the panel discussed was a post-approval review, whereby the compliance department would review and track customer complaints related to the new product six to twelve months after approval by the New Products Committee. The panel ended the session by stressing the establishment of a New Products Committee does not eliminate suitability risk, which must be considered by all registered representatives when engaging in any sales activities. ◀

Deferred Variable Annuity Sales

It has been a long wait, but the deferred variable annuity rule has been approved by the SEC. In 2004, FINRA sent a request for comment on its proposed rule for sales and supervision of deferred variable annuity product transactions.

The rule includes suitability, disclosure, principal review, supervisory procedures and training requirements tailored specifically to transactions in deferred variable annuities and subaccount allocations.

Most notably, the rule contains unique requirements that similar product-specific rules do not contemplate. The disclosures and representations to customers must be documented and signed by the registered representative making a recommendation to effect an exchange from one variable deferred product to another. Also, a principal must pre-approve the variable annuity application prior to send-

ing it to the insurance company and the approval must be obtained within 7 days of the customer signing the account. Broker-dealers must provide deferred variable product-specific training programs to registered representatives and principals to ensure their understanding of the rule and the products' characteristics and features.

The rule was approved by the SEC on September 7, 2007 but an effective date has not yet been established by FINRA. Broker-dealers can anticipate that the effective date will be no later than March 2008. ◀

Regulation NMS

The final phase of Regulation NMS became effective as of October 8, 2007. Is your firm in compliance? Regulation NMS has now been implemented and there are some critical issues that broker-dealers executing, routing or otherwise trading equity securities should consider.



Trade Reporting Modifiers

Broker-dealers need to ensure that traders have a clear understanding of when to use the different trade reporting modifiers.

- Monitor the implementation of and compliance with the firm's procedures; and
- Re-evaluate the effectiveness of the firm's procedures.

Written Supervisory procedures

FINRA has begun to request broker-dealers' Regulation NMS written supervisory procedures during routine examinations. The written supervisory procedures should not just recite the rule, but when adopting procedures, broker-dealers generally must:

- Specify, in writing, the firm's policies and procedures for compliance with rules;
- Identify how supervisory reviews will be conducted and documented;
- Identify the principal(s) responsible for conducting reviews;
- Specify the minimum frequency of the reviews;

FINRA Surveillance

FINRA is conducting surveillance of broker-dealers' trading activity, trade reporting and OATS reporting. FINRA's Market Regulation department is in the process of generating letters to broker-dealers that FINRA has identified as potentially non-compliant firms.

The SEC has published a frequently asked questions document that focuses on two of the key rules (610 and 611) under Regulation NMS. These rules govern the areas under which most of the violations will be cited by FINRA. ◀

FINRA Gateway – Multi-Phased Rollout Initiated

During its annual Fall Securities Conference, FINRA officially launched the first phase of its “FINRA Gateway” application.

This announcement marked FINRA’s first step, as promised, to create a more user friendly and efficient regulatory model that will assist in streamlining the examination process.

The FINRA Gateway application, once all phases have been rolled out, will provide a single access point for member firms to utilize all FINRA applications. The FINRA Gateway will act as a tool that should simplify compliance tasks and expedite the reporting activities that firms must perform. It features some of the most frequently used regulatory applications, including the Central Registration

Depository (CRD), Financial and Operational Combined Uniform Single Reports (FOCUS), the Order Audit Trail System (OATS) and the Investment Adviser Registration Depository (IARD). The application will also include a number of other customizable features that will allow member firms to tailor their interface with alerts, frequently used tasks, and rule update notifications. The current phase of the application is only available to approximately 1,600 firms. The application is anticipated to be rolled out fully by the end of 2007. ◀

Did You Know?

CRD Search

A broker-dealer must receive authorization from an individual prior to conducting a CRD background search on the individual. A broker-dealer is allowed to conduct a search on FINRA’s public “BrokerCheck” website without obtaining authorization. This is a frequent oversight at broker-dealers and a common violation noted during regulatory examinations.

Business Continuity Plan (“BCP”)

A broker-dealer must annually review and test its BCP and provide disclosures to its customers to summarize the manner in which its BCP addresses the possibility of significant business disruptions. The disclosure must, at a minimum, be made in writing to customers at account opening, posted on the broker-dealer’s web site (if it maintains a web site), and mailed to customers upon request.

Financials

One of the most frequent causes of net capital deficiencies is a firm’s failure to classify properly a rendered court judgment or lawsuit. In either case, at minimum, the amount noted in the judgment or lawsuit should be booked as a contingent liability and included in the calculation of aggregate indebtedness, unless an opinion of counsel indicates otherwise. The failure to obtain a legal opinion will result in an inclusion of the disputed amounts within the firm’s liabilities, which may exhaust excess net capital.

A broker-dealer that is the subject of an adverse award in an arbitration should, for net capital purposes, deduct the award at the time the award is made, even though the appeal process has not been exhausted and no judgment has been rendered. In addition, the award must be included in Aggregate Indebtedness, as there is no exclusion for adverse arbitration awards under Exchange Act Rule 15c3-1(c)(1). ◀

Filing Dates

2007 Monthly/Quarterly FOCUS

Part II/IIA Filings

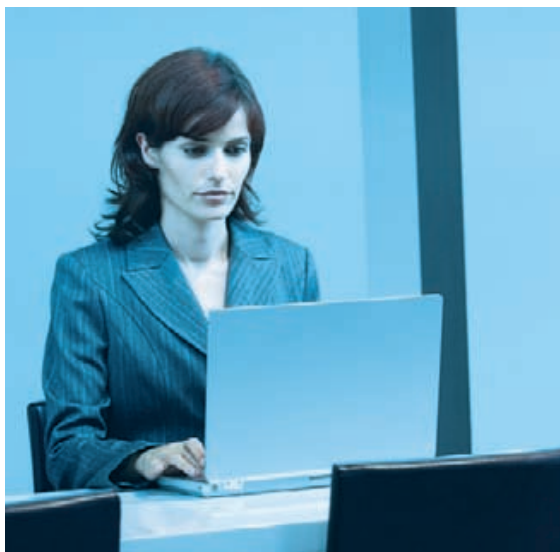
MONTH ENDING	DUE DATE
October 31, 2007	November 26, 2007
November 30, 2007	December 26, 2007
December 31, 2007	January 25, 2008

2007 Annual Audit Filings

FISCAL YEAR END	DUE DATE
October 31, 2007	December 31, 2007
November 30, 2007	January 29, 2008
December 31, 2007	February 29, 2008

2007 Customer Complaint Filings

QUARTER ENDING	DUE DATE
4th quarter 2007	January 15, 2008



2007 FINRA Contact System

December 31, 2007

New NASD Rule 1160 (Contact Information Requirements) becomes effective December 31, 2007. The new rule requires firms to update designated contact information promptly upon any material change, verify such information annually, and comply promptly with any request for such information.

FINRA 2008 Registration Renewal Process

Begins on November 5, 2007

October 22, 2007

Firms may start submitting post-dated Forms U5 and BR Closing/Withdrawal filings via Web CRD.
November 1, 2007

Firms may start submitting post-dated Form BDW via Web CRD, as well as Form ADV-W via IARD. The Preliminary Renewal Statement displays a list of Renewal Fees owed as of close of business on November 2, 2007. Post-dated filings that are submitted prior to 11 p.m. Eastern Time on November 2, 2007 will not appear on the firm's Preliminary Renewal Statement. December 31, 2007 is the only date that can be used for a post-dated termination filing.

November 5, 2007

Preliminary Renewal Statements are available on Web CRD.

December 10, 2007

Full amount of renewal fees shown on Preliminary Renewal Statements is due. ◀

Regulatory Notices, Updates, and Rule Changes

FINRA – REGULATORY NOTICES/ NOTICES TO MEMBERS

SEPTEMBER

Regulatory Notice 07-45 Amendments to NASD Rule 3210 to Conform with Amendments to the SEC's Regulation SHO Delivery Requirements; Effective Date: October 15, 2007.

Regulatory Notice 07-44 SEC Approves New Interpretive Material That Authorizes FINRA to Establish a Temporary Program to Allow Firms to Voluntarily Remit Accumulated Funds; Reminder Concerning Proper Disclosure of the Section 3 Fee; Effective Date: December 11, 2007; Sunset Date: June 11, 2008.

Regulatory Notice 07-43 FINRA Reminds Firms of their Obligations Relating to Senior Investors and Highlights Industry Practices to Serve these Customers.

Regulatory Notice 07-42 SEC Approves NASD Rule 1160 Regarding Firm Contact Information; Effective Date: December 31, 2007.

Regulatory Notice 07-41 Member Firms are Reminded to Register with FINRA Associated Persons Who also are Registered with Another SRO in a FINRA-Recognized Registration Category.

AUGUST

Regulatory Notice 07-40 SEC Approves Exception to Three Quote Rule and Related Recordkeeping Requirements for Certain Foreign Securities; Effective Date: September 28, 2007.

Regulatory Notice 07-39 SEC Approves Amendments Regarding OATS Routing Method Code for Intermarket Sweep Orders; Effective Date: February 4, 2008.

Regulatory Notice 07-38 FINRA Extends Implementation of Rule Amendments Relating to Non-Tape (Or Clearing-Only) Reports for Previously Executed Trades; Revised Effective Date: November 5, 2007.

Regulatory Notice 07-37 Extension of Pilot Program Increasing Position and Exercise Limits for Stock Options; Notice Posted on August 28, 2007.

Regulatory Notice 07-36 FINRA Clarifies Guidance Relating to SEC Regulation S-P under Notice to Members 07-06 (Special Considerations When Supervising Recommendations of Newly Associated Registered Representatives to Replace Mutual Funds and Variable Products); Notice Posted on August 13, 2007.

Regulatory Notice 07-35 Extension of Temporary Relief from NYSE Rule 409(f) (Statements of Accounts to Customers) to January 1, 2008; Notice Posted on August 6, 2007.

Regulatory Notice 07-34 SEC Approves Amendments Relating to the Issuer-Directed Provisions of Rule 2790; Effective Date: September 5, 2007

JULY

Notice To Member 07-32 NASD Amends Rule 3013 and Interpretive Material 3013 to Permit Members to Designate Co-Chief Executive Officers and Multiple Chief Compliance Officers; Compliance Date: July 16, 2007.

Notice To Member 07-31 NASD Rule Changes to Conform with Amendments to SEC Rule 10a-1 and Regulation SHO; Compliance Date: July 6, 2007.

FINCEN RULES AND RELEASES

SEPTEMBER

Joint Release - FinCEN and OCC Assess Civil Money Penalties Against Union Bank of California.

AUGUST

Final Rule for Section 312 of the USA PATRIOT ACT, clarifying the risk-based procedures that U.S. financial institutions should use in tailoring their enhanced due diligence to assess the risks of some foreign banking relationships.

Joint Release Civil money penalties assessed against American Express Bank International and American Express Travel Related Services Company, Inc.

Joint Release Agencies Release Revised Bank Secrecy Act/Anti-Money Laundering Examination Manual.

Comments by FinCEN Director James H. Freis, Jr. on the Federal Financial Regulators' Statement on BSA/AML Enforcement

SEC RELEASES

SEPTEMBER

Release No. IA-2653 Temporary Rule Regarding Principal Trades with Certain Advisory Clients; Effective Date: September 30, 2007, except Advisers Act Rule 206(3)-3T (effective from September 30, 2007 until December 31, 2009)

Release No. 34-56502 Exemptions for Banks Under Section 3(a)(5) of the Securities Exchange Act and Related Rules; Effective Date: November 2, 2007

Release No. 34-56501 Definitions of Terms and Exemptions Relating to the "Broker" Exceptions For Banks (Conforming Version); Compliance Date: Pursuant to Rule 781, banks are exempt from complying until the first day of their first fiscal year that commences after September 30, 2008.

AUGUST

Release No. 34-56212 Amendments to Regulation SHO; Effective Date: October 15, 2007.

Release No. 34-56206 Short Selling in Connection with a Public Offering; Effective Date: October 9, 2007

MSRB NOTICES

SEPTEMBER

MSRB Notice 2007-29 Interpretive Letter Relating to Payments to Non-Political Accounts of Political Organizations Under Rule G-37.

MSRB Notice 2007-27 Implementation of Amendments to Rule G-27 Regarding Supervision; Delayed Until February 29, 2008.

AUGUST

MSRB Notice 2007-26 Real Time Reporting System (RTRS) Web Enhancement: Extended Hours.

MSRB Notice 2007-25 SEC Approval Relating to Reporting Special Condition Indicators for Certain Special Trading Situations.

JULY

MSRB Notice 2007-23 Reminder: Disclosure Requirements Relating to Maximum Sales Load and Total Operating Expense Ratio in Performance Advertisements of Municipal Fund Securities Have Become Effective. ◀

ACA Spring 2008 Compliance Conference

LEARN TO SURVIVE THE DANGEROUS COMPLIANCE WATERS

March 11 – March 13, 2008, Scottsdale, AZ

Explore the most challenging issues affecting compliance through panels and discussions hosted by industry experts and SEC officials.



Topics Include: Soft Dollars, Dealing with Problems, the Compliance Program, Personal Trading, Testing, Advertising, Best Execution, Gifts, SEC Inspections, ERISA, Books and Records, Valuation, and more.

Conference Highlights

ACA's compliance conference will cover the core curriculum of topics that every competent and knowledgeable advisory firm compliance officer should master. All of the sessions will focus on the compliance issues unique to specific types of firms, including large and small investment advisers, private fund managers, and mutual fund advisers.

To learn more, please visit www.acacompliancegroup.com/conference/. ◀