

October 25, 2007

FINRA Fall Securities Conference

The Financial Industry Regulatory Authority (“FINRA”) recently held its first-ever Fall Securities Conference in Scottsdale, Arizona, featuring senior FINRA officers and staff members discussing a variety of industry issues and regulatory developments. This conference, traditionally hosted annually by NASD, was the first national conference hosted by FINRA, which was created in July 2007 by the merger of NASD and the member regulation operations of the New York Stock Exchange (“NYSE”).¹ This Alert presents some of the highlights from the conference and includes, where appropriate, background discussion, information from the conference materials, and links to relevant resources.

Although the Conference included sessions on a wide range of issues, certain key subjects were addressed repeatedly during multiple conference sessions. Those subjects included:

- **Consolidation Update.** FINRA’s ongoing consolidation efforts were, not surprisingly, a topic of significant discussion during the Conference. FINRA officials indicated that firms can expect a consolidated examination process by January 2008. In addition, FINRA anticipates publishing a consolidated rulebook by the end of 2008. Several FINRA officials emphasized that in consolidating NASD’s and NYSE’s rulebooks, FINRA is engaging in a very deliberative review of the existing rules and considering alternative approaches, including the possibility of tiering certain rules based on broker-dealer size or business type.
- **Protection of Senior Investors.** The protection of senior investors emerged from the Conference as one of FINRA’s chief areas of regulatory interest. In fact, the Conference included a separate panel session devoted to this issue. Senior investors will be a priority in FINRA’s examination, enforcement, and education programs.
- **New Rule 2821.** The new rule on deferred variable annuities was discussed by several panels, and it was the focus of the “Insurance Products: Key Regulatory Considerations” session. Rule 2821, which was recently approved by the Securities and Exchange Commission (the “SEC”), will become effective six months after FINRA publishes a notice announcing the approval of the rule and providing related guidance. FINRA officials indicated that while the draft of the notice is virtually complete, it will be published on or about the deadline prescribed by the SEC (November 6, 2007) so as to give member firms the maximum amount of time to prepare for complying with the new rule.

Summarized below are the remarks provided at the Conference by senior FINRA officers and the discussions of several of the panel sessions. For ease of reference, a table of contents containing links to the relevant sections of the Alert has been included. To view the text of a particular section, simply click on the corresponding page number in the table of contents.

¹ At the Conference, there was much discussion about the pros and cons of the new name. Many participants had hoped that the regulators would have chosen a name with more pizzazz, such as Coordinator of the Securities Industry (or CSI: Wall Street). See also “Market Overseer Needs a Name,” *The Wall Street Journal*, May 23, 2007, at B3 (other suggested names not chosen include United States Securities Regulation, or USSR).

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Remarks by FINRA Senior Officers

Mary Schapiro, FINRA's Chief Executive Officer, and Douglas Shulman, FINRA's Vice Chairman, gave remarks at the conference, summaries of which are provided below. In addition, please note that the full text of Ms. Schapiro's remarks can be viewed [here](#).

Chief Executive Officer Schapiro's Remarks

Ms. Schapiro kicked off the conference. She focused on market integrity being essential to maintaining investor confidence, which is "as fundamental an ingredient to the marketplace as money," particularly in these turbulent times. FINRA, she noted, plays a critical role in safeguarding market integrity, but securities regulators and industry members must work together as "partners in investor protection" to achieve that goal. Ms. Schapiro indicated that FINRA, for its part, protects market integrity and promotes investor confidence by, among other things, (1) assisting firms in fulfilling their compliance obligations, and (2) spearheading a more efficient regulatory system.

FINRA's Initiatives to Support Firms' Compliance Efforts

Ms. Schapiro stated that, as promised, FINRA has increased its efforts to communicate with firms and to build tools that assist firms in their compliance efforts. In that regard, she announced two new FINRA initiatives aimed at supporting firm compliance:

- **Firm Gateway.** FINRA has developed a new online portal known as the Firm Gateway that will provide a single point of entry to all FINRA applications and information, including, for example, WebCRD and the Report Center. Among other benefits, the Firm Gateway will make transitioning between applications easier, eliminating the need for users to login separately for each application. In addition, the Firm Gateway will provide filing reminders and centralized alerts and notifications. The Firm Gateway, which was recently launched and is expected to be fully implemented later this year, will be available to approximately 25,000 firm users, mostly compliance personnel. For additional information about the Firm Gateway, please see FINRA's October 11, 2007, press release entitled, "Clicking on Compliance: FINRA Launches Firm Gateway," available [here](#).
- **Small Firm Emergency Partner Program.** This voluntary program was developed by FINRA in consultation with an industry working group and the North American Securities Administrators Association ("NASAA"). It was designed to assist two similar but distant firms in setting up a partnership so that the firms can support one another in the event of a natural disaster or other emergency situation. For example, if an emergency temporarily disables one of the firms, the disabled firm's customer accounts would temporarily be supported by the partner firm. The Small Firm Emergency Partner Program, among other things, provides a template agreement for firms and their common clearing firm that wish to establish such a partnership. For additional information about the Small Firm Emergency Partner Program, please see FINRA's October 11, 2007, press release entitled, "FINRA Announces Small Firm Emergency Partner Program," available [here](#).

FINRA's Efforts to Spearhead a More Efficient Regulatory System

Ms. Schapiro stated that FINRA is "poised to be a catalyst for a more flexible, innovative regulatory approach that will benefit firms and enhance our ability to protect investors." Like the efficiency concerns that led to FINRA's creation in the first place, Ms. Schapiro indicated that FINRA remains committed to streamlining regulation and easing the regulatory burdens on member firms without jeopardizing investor

protection. In this regard, Ms. Schapiro noted FINRA's ongoing efforts to integrate the examination process, merge the NASD and NYSE rulebooks, and respond to the special needs of smaller firms.

- **Integrated Examination Process.** Ms. Schapiro stated that while the consolidation of NASD and NYSE enforcement departments is virtually complete, the consolidation of the examination process is still ongoing, but is anticipated to be complete by January in time for the 2008 examinations. In addition to being more efficient, Ms. Schapiro predicted that FINRA's integrated examination process will be "greater than the sum of its parts, as for the first time a single SRO will have the complete picture of the largest firms' operations – financial, operational, risk and sales practices."
- **Rulebook Consolidation.** In consolidating the NASD and NYSE rulebooks, FINRA is engaging in a "very deliberative process," rather than simply choosing the best of two rules. FINRA is scrutinizing the rules to determine if better, more efficient alternatives exist and considering a "more tiered approach" to the rules that recognizes the diversity of the industry, both in terms of firm size and business model.
- **Needs of Smaller Firms.** Ms. Schapiro directly addressed FINRA's efforts to respond to the needs of smaller firms, some of which were opposed to FINRA's creation. In this regard, she highlighted two recent rule amendment proposals made by FINRA that were initially recommended by the Small Firm Rules Impact Task Force. The first rule, which has already been approved by the SEC, provides that firms need to update their designated contact persons on the FINRA Contact System on an annual basis (the prior rule required quarterly updates) or within 30 days of any change. This rule will be implemented in January. The second proposal, which has yet to be approved by the SEC, would revise NASD Rule 2210 to permit a broker-dealer to use sales material created and filed with FINRA by a distributor without independently reviewing the material. This proposal, Ms. Schapiro indicated, would "eliminate hours of unnecessary work."

Vice Chairman Shulman's Remarks

Mr. Shulman's remarks echoed many of the issues addressed by Ms. Schapiro and centered on three issues: (1) the evolving role of FINRA as a modern regulator; (2) recent market turmoil; and (3) FINRA's efforts to support firms and investors.

- **FINRA as a Modern Regulator.** Mr. Shulman noted that while FINRA's central role – writing and enforcing rules for the securities industry – has not changed, the landscape has. New products have been introduced, stock exchanges have gone public, and the investing population has changed. Mr. Shulman stressed that FINRA will be more proactive in protecting the underserved and vulnerable segments of the investing population, specifically citing the elderly and military personnel.
- **Recent Market Turmoil.** Mr. Shulman addressed the fallout of the subprime credit crunch, which he indicated served as a reminder of the complexity and interconnectedness of today's markets and highlighted the need for regulators and firms to work together to understand these markets and adapt to change.
- **FINRA's Efforts to Support Firms and Investors.** Mr. Shulman cited several FINRA initiatives, including the Firm Gateway (addressed above) and FINRA's Liaison Program (which provides each member firm a designated point of contact to answer questions), as reflecting FINRA's commitment to helping member firms meet their regulatory obligations. In addition, he noted the many webcasts, podcasts, online workshops, and other educational materials on securities issues that FINRA makes available to firms, registered persons and the investing public.

Panel Sessions

This section provides highlights from many of the conference's panel sessions. The panel sessions specifically covered in this section include: Enforcement Hot Topics, Preparing for a Regulatory Examination, Disciplinary Hearing Process, Advertising Regulation, Aging Investors and the Securities Industry, Insurance Products: Key Regulatory Considerations, Supervisory Controls Plenary Session, Developing Written Supervisory Procedures, Anti-Money Laundering, Ask FINRA Staff, Broker-Dealer and Investment Adviser Issues, and New Products: Regulatory and Compliance Considerations.

Enforcement Hot Topics

Susan Merrill, Executive Vice President and Chief of Enforcement, explained certain of FINRA's enforcement priorities, including the following:

- ***Anti-Money Laundering and Suspicious Activity Reporting.*** FINRA will continue to review firms' anti-money laundering compliance policies and procedures and will, when appropriate, recommend that enforcement actions be brought against non-compliant firms.
- ***Hedge Funds.*** Ms. Merrill noted that while FINRA does not have jurisdiction over hedge funds, it does have jurisdiction over certain related broker-dealer conduct, including (1) marketing by broker-dealers, including possible exaggerated and unwarranted statements regarding performance; and (2) aiding and abetting soft dollar arrangements.
- ***Operational Deficiencies.*** Ms. Merrill indicated that FINRA will investigate operational deficiencies and bring enforcement actions based on such deficiencies, similar to the settlement recently announced by NYSE Regulation relating to 15 firms that failed to comply with prospectus delivery requirements and other operational and supervisory violations. To view the press release for the NYSE Regulation settlement, please click [here](#).
- ***Protection of Senior Investors.*** Ms. Merrill noted that the staff will seek expedited treatment for cases involving senior investors to ensure that the investigations are completed more quickly than other enforcement investigations. The recent sweep examinations regarding the use of senior designations and retirement seminars were also mentioned.

For additional information about those sweeps, please see:

1. Sutherland's Legal Alert titled, "Sutherland to Host Conference Calls on FINRA Sweep Examination of the Use of Professional Designations Involving Seniors and Retirees," available [here](#); and
 2. Sutherland's Legal Alert titled, "FINRA Conducting a Sweep Examination of Pitches to Retirees and Section 72(t) Withdrawals," available [here](#).
- ***Research Analyst Issues.*** Ms. Merrill stated that Enforcement will continue to investigate research analyst issues, including trading during blackouts and inadequate disclosures.
 - ***Subprime Mortgage Market.*** Ms. Merrill stated that a sweep examination is underway involving packaged subprime loans sold to retail investors. The examination is focused primarily on suitability issues. FINRA is also looking at valuation issues and the possibility of market manipulation.

Preparing for a Regulatory Examination

The panel noted that there are three different types of examinations: (1) cycle examinations (e.g., routine examinations and examinations relating to municipal securities, options, and statutory disqualifications), which are generally announced up to 30 days prior to commencement; (2) cause examinations (including examinations relating to customer complaints, terminations for cause, branch offices, and surveillance); and (3) sweep examinations, which generally are in response to issues of emerging regulatory interest. The panel discussion focused primarily on cycle and cause examinations. Specifically, the panel addressed the following issues: (1) preparing for a cycle examination; (2) common cycle examination findings; (3) common cause examination findings; and (4) FINRA's 2007 examination priorities.

(1) Preparing for a Cycle Examination

The panel provided the following practical pointers for firms undergoing a cycle examination:

- Before an examination, firms should review the webcast titled, "What to Expect: Preparing for a FINRA Routine Examination," available [here](#).

For additional information about preparing for examinations, please see:

"Practical Pointers for Regulatory Exams," authored by Sutherland's Deborah Heilizer, Clifford Kirsch and Brian Rubin, available [here](#).

- Firms should review prior examinations findings in preparation for an examination.
- Dialogue between firms and the staff is vital during all phases of the examination.
- It is generally a good idea for firms to have one point person to deal with the examination staff.
- Firms should inform the staff if another regulator is looking at a similar issue; regulators generally do not want to subject firms to redundant requests.
- Firms should generally inform management and employees that the examination is occurring.
- The staff generally informs firms of "apparent discrepancies" at the end of the onsite visit and gives firms the opportunity to "explain away" those discrepancies.
- If a firm is asked to respond to a violation, the firm should ensure that it is capable of addressing the violation as set forth in the response.

The panel also provided the following cycle examination statistics:

- Examinations are generally closed out in four to five months.
- Fewer than 10% of cycle examinations lead to formal actions.

(2) Common Cycle Examination Findings

The panel noted the following common examination findings for cycle examinations:

- Inadequate supervisory systems or written supervisory procedures (NASD Rule 3010 or MSRB Rule G-27);

- Deficient supervisory control system (NASD Rule 3012);
- Deficient Form U4 or U5 filings (FINRA By-Laws, Article V, Sections 2 and 3);
- Inadequate anti-money laundering compliance program (NASD Rule 3011 and MSRB Rule G-41);
- Deficient business continuity plans or inadequate reporting of emergency contact information (NASD Rules 3510 and 3520);
- Deficient transaction reporting (MSRB Rule G-14);
- Failure to prepare and maintain books and records (SEC Rules 17a-3 and 17a-4);
- Deficient transaction reporting of TRACE eligible securities (NASD Rule 6230); and
- Deficiencies relating to the annual certification of compliance and supervisory processes (NASD Rule 3013).

(3) Common Cause Examination Findings

The panel also highlighted the following common examination findings for cause examinations:

- Inadequate supervisory systems or written supervisory procedures (NASD Rule 3010 or MSRB Rule G-27);
- Failure to provide information in a timely manner (NASD Rule 8210);
- Failure to prepare and maintain books and records (SEC Rules 17a-3 and 17a-4);
- Deficient Form U4 filings (FINRA By-Laws, Article V, Section 2);
- Unsuitable sales (NASD Rule 2310);
- Deficiencies relating to outside business activities (NASD Rule 3030);
- Deficiencies relating to reports required to be made by certain broker-dealers under SEC Rule 17a-5;
- Deficiencies relating to communications with the public (NASD Rule 2210); and
- Deficiencies relating to private securities transactions (NASD Rule 3040).

(4) FINRA's 2007 Examination Priorities

The panel also reviewed FINRA's examination priorities for 2007, which were similar to the priorities for 2006. Those examination priorities include:

- Anti-Money Laundering;
- Data Integrity, including the integrity of information provided to FINRA through 3070 filings, Form U4/U5 filings, and blue sheeting;

- Electronic Storage Media;
 - Regulation S-P and the Protection of Customer Information;
 - Seniors and Sales Seminars;
 - Suitability;
 - Supervision and Supervisory Controls;
 - Transaction Reporting; and
- Variable Insurance Products.

Disciplinary Hearing Process

The panel discussed various issues regarding the lifecycle of a disciplinary proceeding, including the following:

- ***Appointment of Hearing Officer and Hearing Panel.*** After a complaint is filed, the Chief Hearing Officer appoints a three-member hearing panel to conduct the hearing and issue a decision. Each hearing panel is chaired by a hearing officer, who is an attorney employed by FINRA. The other two panelists are industry members.
- ***Pleading Standard for Complaints.*** Complaints must specify in reasonable detail the alleged misconduct and the rule allegedly violated. Respondents may file motions for a more definite statement if they believe the complaint is not sufficiently particular. Such motions have been granted when, for example, the complaint failed to identify the particular violative transactions underlying the charges. See, e.g., OHO Order 03-18 (CLI030017), available [here](#).
- ***Answers.*** In an answer, a respondent must admit, deny or state that he has insufficient information to admit or deny, each allegation of a complaint. In addition, a respondent must assert in the answer all of his affirmative defenses. Hearing officers may permit answers to be amended based on “good cause shown by the Respondents”; however, hearing officers have refused to allow respondents to amend their answers when, for example, the amendments are not based on newly discovered evidence and the respondent has otherwise failed to demonstrate good cause for the amendments. See, e.g., OHO Order 04-03 (C8A030100), available [here](#).
- ***Discovery Issues.*** Enforcement is obligated to provide respondents with documents prepared or obtained by Enforcement staff in connection with the investigation that led to the enforcement action. See NASD Procedural Rule 9251. However, the staff may withhold certain documents under Procedural Rule 9251(b)(1), including documents protected by the attorney-client privilege and certain documents prepared by FINRA staff members. In addition, Enforcement is obligated to disclose material exculpatory evidence to the extent that it was obtained by the staff in connection with the investigation that led to the enforcement action. See OHO Order 01-13 (CAF000045), available [here](#). The panel had a spirited discussion about whether Enforcement “hides the ball” or produces everything required. NASD rules also permit respondents to obtain third-party discovery and the production of witness statements.
- ***Pre-Hearing Motions.*** NASD hearing officers and hearing panels rule on a variety of pre-hearing motions, including motions for partial or full summary disposition and certain evidentiary motions.

- *Motions for Summary Disposition.* NASD Rule 9264(e) provides that the hearing panel may grant a motion for summary disposition when there is “no genuine issue with regard to any material fact and the [p]arty that files the motion is entitled to summary disposition as a matter of law.” Such motions are rarely granted.

For more information about motions for summary disposition, please see OHO Order 03-06 (C3B020015), available [here](#).

- *Evidentiary Motions.* NASD Rule 9263(a) provides that the hearing officer shall receive relevant evidence and may exclude any evidence that is “irrelevant, immaterial, unduly repetitious, or unduly prejudicial.” Accordingly, hearing officers rule on various types of evidentiary motions, including, for example, motions to permit expert testimony, motions in limine, and motions to limit evidence.

For examples of the rulings, please see:

- 1) OHO Order 05-35 (CAF040058), available [here](#) (motion to permit expert testimony);
- 2) OHO Order 05-37 (C3A040045), available [here](#) (motion in limine); and
- 3) OHO Order 06-12 (CL1050016), available [here](#) (motion to limit evidence).

- ***Pre-Hearing Conferences.*** The hearing officer may hold one or more pre-hearing conferences aimed at getting the parties to agree on undisputed facts and establishing procedures for the efficient administration of the proceeding.
- ***Hearings.*** The hearing provides both Enforcement and the respondent(s) the opportunity to present documentary and testimonial evidence material to the disputed issues. Case dispositions are determined by a majority vote of the hearing panel.
- ***Appeals.*** Hearing panel decisions for disciplinary proceedings can be appealed by either party to the National Adjudicatory Council (“NAC”). In addition, the NAC may, on its own motion, call a particular disciplinary proceeding for review. NAC decisions can be appealed to the SEC.

For additional information on the disciplinary process, please see:

- 1) FINRA’s Guide to Disciplinary Hearing Procedures, available [here](#); and
- 2) “Unless They Make You an Offer You Can’t Refuse: Litigating Against NASD and the NYSE,” written by Sutherland’s Brian Rubin and Christian Cannon, available [here](#).

- ***Success of the Enforcement Staff Litigating Against Respondents.*** The panel discussed the fact that generally Enforcement is successful in establishing liability in disciplinary proceedings. One panelist likened it to playing basketball against Duke at Cameron Indoor Stadium.

For additional information on this subject, see:

- 1) Sutherland’s Legal Alert titled, “Sutherland Study Finds That It Sometimes Pays to Litigate Against FINRA (Formerly NASD),” available [here](#); and

- 2) "The House That the Regulators Built (Revisited): An Analysis of Whether Respondents Should Litigate Against NASD," written by Sutherland's Brian Rubin and Christian Cannon, available [here](#).

Advertising Regulation

This panel included Tom Pappas (Vice President, FINRA Advertising Regulation), Amy Sochard (Director, Programs & Investigations, FINRA Advertising Regulation), and Anthony Maher (Supervisor, FINRA Advertising Regulation) and addressed regulatory developments relating to FINRA's regulation of member communications with the public, including: (1) recent rule amendments, (2) new rule proposals, (3) recent interpretative guidance, and (4) other current issues and trends.

(1) Rule Amendments

The panel discussed two recent rule amendments relating to communications with the public: one relating to the Municipal Securities Rulemaking Board's advertising rules and the other relating to sales materials that contain mutual fund performance data.

- **Amendments to MSRB's Advertising Rules.** Mr. Pappas addressed the recent amendments to MSRB Rule G-21, describing them as a "major step" towards harmonizing MSRB and NASD rules in this area. Rule G-21 applies to advertisements relating to municipal fund securities, including interests in 529 college savings plans. Mr. Pappas focused on the following five aspects of the amendments:
 - *Disclosures Required.* The amendments clarify that specific disclosure legends are not required; however, basic information about the security, including, for example, the associated risks and costs, must be "effectively conveyed."
 - *Disclosure of Home State Tax Benefits.* Advertisements and sales literature for 529 plans generally must disclose that an investor should consider, before investing, whether his or her home state offers tax or other benefits available only for investments in the home state's 529 plan. The amendments provide that this home state tax benefit disclosure can be omitted when an advertisement concerns a state's 529 plan, and it is distributed through means that are reasonably likely to result in the advertisement being received only by residents of that state.
 - *Form Letter Disclosures.* The amendments permit the omission of certain disclosures in form letters to existing clients.
 - *Tax Disclosures.* The amendments provide that a generalized statement regarding the tax benefits of a municipal fund security need be balanced only by a generalized statement that such benefits may be conditional. However, if specific tax benefits are discussed, that discussion must be balanced with disclosure of the specific factors that may limit the availability of those tax benefits.
 - *Generic Advertisements.* The amendments generally permit the omission of certain disclosures in advertisements that do not refer by name to any specific investment option or portfolio offered by a municipal fund securities issuer.
 - For more information about these amendments, please see MSRB Notice 2007-18, available [here](#).

- **Amendments to Mutual Fund Performance Disclosure Rules.** Ms. Sochard addressed the amendments to NASD Rules 2210 and 2211 that became effective April 1, 2007 relating to sales materials that contain non-money market mutual fund performance data. These amendments do not apply to variable product funds or unit investment trusts. Pursuant to those amendments, such materials must disclose (1) the standardized performance information mandated by SEC rules; and (2) to the extent applicable, the fund's maximum front-end or back-end sales charge and annual operating expense ratio. The amendments further require that this information be disclosed prominently; in addition, for print advertisements, this information must be disclosed in a text box.

For more information about these amendments, please see NASD Notice to Members 06-48, available [here](#).

(2) Rule Proposals

The panel highlighted four recent rule proposals relating to member communications with the public.

- **Exception to Principal Approval Requirement for Certain Filed Materials.** Mr. Pappas noted the recently proposed amendment to NASD Rule 2210 that would provide a limited exception to the principal approval requirement for sales material previously filed with FINRA. Under this exception, a broker-dealer would no longer need to review and approve pieces created by, and previously filed with FINRA by, another firm provided that (1) the broker-dealer did not make any material changes to the content or use of the piece; and (2) the other firm previously received a letter from FINRA stating that the piece was "consistent with applicable standards." This rule would most commonly be used for sales material created by a fund distributor and used by a selling broker-dealer. In connection with this rule proposal, Mr. Pappas noted that FINRA intends to create a database of filed materials that would permit a submitter of a piece to specify other broker-dealers that can access it. Mr. Pappas indicated that FINRA has received comments from the SEC on this rule proposal and that he is "optimistic" that it will be approved. To view the full text of the rule proposal, please click [here](#).
- **Modernization of Options Communications Rules.** Ms. Sochard discussed the proposed amendment to NASD Rule 2220 concerning options communications. The proposed rule is designed to modernize the existing rule by, among other things, making it clear that Rule 2220 applies to electronic communications. In addition, the amendments would make Rule 2220 parallel to Rule 2210 by providing that all advertisements, pieces of sales literature, and independently prepared reprints need to be approved by a registered options principal prior to use. In contrast, correspondence and institutional sales materials need not be approved prior to use, although their use must still be supervised by the member firm. The amendments also clarify that all advertisements, pieces of sales literature, and independently prepared reprints concerning standardized options used prior to delivery of the applicable current options disclosure document must be filed with FINRA's Advertising Regulation at least 10 days prior to use. Ms. Sochard indicated that comments from the SEC have been received on this rule proposal and that FINRA expects to file an amended proposal shortly. To view the text of the proposed rule, in its current form, please click [here](#).
- **Proposed Variable Insurance Product Guidelines.** Mr. Pappas indicated that a proposed amendment to NASD IM-2210-2 is planned. He noted that IM-2210-2 is approximately 15 years old. While the staff has provided notices and additional guidance in the interim, those materials have yet to be formally codified. Mr. Pappas noted that the proposed amendment would likely focus on variable product illustrations, which are not sufficiently addressed in IM-2210-2 as it currently exists.

- **Proposed Guidance for the Review and Supervision of Electronic Communications.** Ms. Sochard discussed NASD Notice to Members 07-30, issued in June 2007, that requested comment on proposed guidance regarding the supervision of electronic communications. The Notice provided guidance concerning, among other things: (1) the written policies and procedures needed; (2) the types of electronic communications that should be reviewed; (3) the need to identify the persons responsible for reviewing electronic communications; (4) the appropriate methods for reviewing electronic communications; (5) the frequency that electronic communications should be reviewed; and (6) how to evidence reviews of electronic communications. Ms. Sochard stated that FINRA received 15 comment letters in response to this Notice and that FINRA's goal is to provide the final guidance shortly. To view the full text of Notice to Members 07-30, please click [here](#).

For additional information about Notice to Members 07-30, please see:

Sutherland's Legal Alert titled, "NASD and NYSE Request Comments on Proposed Guidance Regarding Supervision of Electronic Communications," available [here](#).

(3) Interpretative Guidance

Mr. Pappas discussed the staff interpretative letter issued on September 6, 2007, in response to a request from the Investment Company Institute. He noted that the letter provides that business cards and letterhead need not be filed with FINRA if their content is limited to (1) the firm or individual's contact information; (2) the firm's logo; (3) a list of the firm's affiliated companies; and/or (4) a list of the firm's product or services. To view the full text of the interpretative letter, please click [here](#).

(4) Current Issues and Trends

The panelists identified several current issues and trends relating to communications with the public, including the following:

- **Effect of Consolidation.** Mr. Pappas indicated that FINRA would be "pretty flexible" with respect to permitting member firms to use up their existing inventories of sales material that reference NASD.
- **The Senior Initiative.** Ms. Sochard noted that Advertising Regulation was involved in reviewing sales materials collected in connection with the recent "free lunch" examination sweep. That review revealed the following concerns with respect to certain pieces: (1) material omissions; (2) use of aggressive "teaser" language; (3) misuse of professional designations; and (4) inadequate explanations of the investments or strategies involved. Ms. Sochard also referenced the interpretative letter issued on September 28, 2007, in response to a request from the Society of Certified Senior Advisors. In the interpretative letter, FINRA refused to pass judgment on the Certified Senior Advisors designation and reiterated its position, previously stated in Notice 07-43, that firms that permit representatives to use professional designations must have policies and procedures to ensure that the designations are legitimate and are not being used in a misleading manner. To view the full text of the interpretative letter, please click [here](#).
- **Blogs, Bulletin Boards & Chat Rooms.** Ms. Sochard indicated that blogs and bulletin board postings constitute advertisements and are subject to NASD content standards, principal approval requirements, recordkeeping requirements, and filing requirements. She also stated that unscripted chat room participation is a public appearance and must be supervised pursuant to Rule 3010. In addition, she noted that firms sponsoring blogs, bulletin boards, or chat rooms are obligated to supervise the content and operation of such facilities, including the supervision of third-party postings.

- **Changes to AREF.** Ms. Sochard stated that effective October 29, 2007, firms submitting sales material for review by FINRA staff through the Advertising Regulation Electronic Files (“AREF”) system will need to provide additional information about their submissions, including (1) the definition of the piece (e.g., “advertisement,” “sales literature”); (2) the delivery method; (3) the type of product discussed; (4) the approving principal’s CRD number; and (5) a statement, if applicable, indicating that the firm is waiting to use the piece until it hears back from FINRA. This additional information is being requested to assist FINRA in prioritizing its review of the pieces submitted. In addition, also effective October 29, 2007, firms will have the ability to upload with each filing additional supporting documentation and/or a cover letter.

Aging Investors and the Securities Industry

The conference devoted a separate panel session to the growing regulatory concern about the protection of aging investors. This concern is particularly pronounced in today’s market, given the aging of the population and the consequent increase in the number of senior investors. This panel focused on the most notable regulatory initiatives and other recent developments in this area, including (a) the sweep examinations; (b) FINRA’s recently issued Notice 07-43; (c) relevant enforcement actions; (d) the recent Senate hearing; and (e) investor education initiatives. In addition, the panel, which included representatives from FINRA, the SEC, NASAA and AARP, emphasized the collaboration underlying the regulatory efforts in this area and that the protection of aging investors is a shared priority.

- **Sweep Examinations.** The panel discussed that FINRA and the SEC, both alone and in collaboration, have initiated several sweep examinations relating to senior investor issues. For example, the SEC, FINRA, and several states conducted a joint examination of “free lunch” seminars. That sweep examination found the following: (1) in 60% of the examinations, firms inadequately supervised the seminars at issue; (2) in 50% of the examinations, firms used advertisements or sales literatures that were misleading or exaggerated; (3) in 23% of the examinations, there were indications that unsuitable recommendations were made to seminar attendees either during the seminars or after the seminars; and (4) in 13% of the examinations, there were indications of fraudulent practices, including, for example, the sale of fictitious securities and unauthorized trading. In addition to the joint free lunch examination, FINRA has conducted independent examinations of (a) sales pitches to retirees and the use of 72t withdrawals, and (b) the use of professional designations that suggest expertise in advising retirees and/or seniors.

For additional information about sweep examinations regarding senior issues, please see:

- 1) Joint report by the SEC, FINRA and NASAA titled, “Protecting Senior Investors: Report of Examinations of Securities Firms Providing “Free Lunch” Sales Seminars,” available [here](#);
 - 2) Sutherland’s Legal Alert titled, “Sutherland to Host Conference Calls on FINRA Sweep Examination of the Use of Professional Designations Involving Seniors and Retirees,” available [here](#); and
 - 3) Sutherland’s Legal Alert titled, “FINRA Conducting a Sweep Examination of Pitches to Retirees and Section 72(t) Withdrawals,” available [here](#).
- **Regulatory Guidance.** The panel discussed Regulatory Notice 07-43, which was recently published by FINRA to address various issues relating to aging investors. Specifically, Regulatory Notice 07-43 addresses special suitability concerns relating to senior investors, the misleading use of senior designations and credentials, high-pressure sales seminars targeting

seniors, and diminished capacity. Ms. Schapiro commented on the issue of diminished capacity, noting that firms should ensure that situations of potential diminished capacity are escalated within the firm. In addition, she stated that firms may want to consider asking, at the outset of the customer relationship, that the customer identify a second person who could be contacted by the firm if concerns about capacity later arise. The panel also suggested that additional guidance could be forthcoming; both the SEC and FINRA indicated that they are continuing to collect information from firms about best practices in this area.

- To view the full text of FINRA Regulatory Notice 07-43, please click [here](#).
- **Enforcement Actions.** Panelist Lori Richards, the Director of the SEC's Office of Compliance Investigations and Examinations, stated that the SEC has prioritized enforcement actions involving senior fraud and has brought more than 30 such actions.
- **Recent Senate Hearing.** Karen Tyler, the new President of NASAA, discussed the recent Senate hearing on senior investor issues. She noted that the hearing focused primarily on: (1) free lunch seminars; (2) the use of professional designations; and (3) annuity sales practices.
- **Training and Education.** Ms. Schapiro announced that FINRA recently published a new webcast on dealing with senior investors and meeting their investment needs. That webcast, entitled "Suitability Considerations for Work with Seniors," is available on FINRA's [Web site](#) to registered persons. In addition, the panel noted that FINRA, the SEC, NASAA and AARP have all developed investor education initiatives designed to inform and protect senior investors.

Insurance Products: Key Regulatory Considerations

This panel principally discussed new Rule 2821 (the new rule on variable annuities), which has been approved by the SEC and will become effective six months after FINRA publishes a notice announcing the rule's approval (expected to occur in early November 2007). The panel addressed the application of the rule, the scope of the rule, and certain industry concerns about the rule.

(1) Application of Rule 2821

Rule 2821 will apply to the purchase or exchange of a deferred variable annuity and the initial subaccount allocation. However, the rule will generally not apply to deferred variable annuity transactions made in connection with qualified plans, except in the case that an associated person makes a recommendation to an individual plan participant regarding the annuity.

(2) Scope of Rule 2821

The panel reviewed the four main sections of the new rule – recommendation requirements; principal review and approval; supervisory procedures; and training.

- **Recommendation Requirements.** Rule 2821(b) addresses three issues relating to recommendations of deferred variable annuity purchases or exchanges: (1) general suitability requirements; (2) special suitability considerations for exchanges; and (3) the suitability information that firms must obtain from customers prior to recommending a deferred variable annuity.
 - **General Suitability Requirements.** In addition to determining suitability under NASD Rule 2310, persons recommending the purchase or exchange of a variable annuity must also have a reasonable basis for believing that: (a) the customer has been informed, in general terms, of the various features of the deferred variable annuity, including, for example, the surrender

period, the surrender charge, the market risk, and the mortality and expense fees; (b) the customer would benefit from certain features of the deferred variable annuity, such as tax-deferred growth, annuitization or a death or living benefit; and (c) the variable annuity itself, the underlying subaccounts to which funds will be allocated, and any riders are suitable for the customer.

- **Special Suitability Considerations for Exchanges.** In addition to the standards above, persons recommending the exchange of a deferred variable annuity must have a reasonable basis for believing the exchange is suitable, taking into consideration, among other things, whether the client will incur a surrender charge, be subject to a new surrender period, lose existing benefits, or be subject to an increase in fees.
- **Suitability Information Required.** Prior to recommending the purchase or exchange of a deferred variable annuity, a person must make reasonable efforts to obtain, at a minimum, information about the customer's age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the annuity, investment time horizon, existing assets, liquidity needs, liquid net worth, risk tolerance, tax status, and such other information as the member firm or associated person believes is reasonable.
- **Principal Review and Approval.** Rule 2821(b) will require that, prior to transmitting an application for a deferred variable annuity to the issuer, but no later than seven business days after the customer has signed the application, a registered principal must review and approve the purchase or exchange of the annuity. The principal should approve the transaction only if he or she has a reasonable basis for believing that the transaction is suitable, subject to the suitability requirements described in the rule.
- **Supervisory Procedures.** Rule 2821(c) will require that member firms establish and maintain specific written supervisory procedures that are reasonably designed to achieve compliance with this rule. In addition, member firms must (a) implement surveillance procedures to determine if any associated persons "have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this rule, other applicable NASD rules, or the federal securities laws ('inappropriate exchanges')"; and (b) establish policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and associated persons who engage in inappropriate exchanges.
- **Training.** Rule 2821(d) will require that member firms develop and document specific training policies or programs that are reasonably designed to ensure compliance with this rule.

(3) Industry Concerns

The panel discussed certain industry concerns about new Rule 2821, including (1) the propriety of the principal review and approval requirement; and (2) the ability of broker-dealers to monitor exchanges involving annuities issued by outside product providers.

- **Principal Review and Approval Requirement.** An industry panelist noted that this aspect of Rule 2821 represents a "fundamental change" in the concept of sales supervision for this one particular product. The principal's review is no longer limited to looking for red flags of potential unsuitability; under Rule 2821, the principal will have to put himself in the shoes of the selling representative and make his own suitability determination. In addition, this panelist questioned the workability of the principal review and approval timeline, which, she argued, should run from the date the firm receives the application, not the date the customer signed the application. Larry Kosciulek, Director, FINRA Investment Companies Regulation, stated that he believes the

heightened principal review standard is warranted for deferred variable annuities based on recent and historical concerns about sales of this product.

- **Monitoring of Exchanges.** An industry panelist also questioned how a broker-dealer will be able to monitor exchange activity involving deferred variable annuities issued by outside product providers. This panelist indicated that her firm offers deferred variable annuities from approximately 200 outside providers. She stated that, at some point, the burden needs to shift to the customer because the customer is the only one who knows all of his or her other holdings.

Supervisory Controls Plenary Session

Among the issues discussed by this panel were (1) how to perform the testing and verification required by NASD Rule 3012; (2) the application of the limited resources exception to Rule 3012; and (3) recent examination findings relating to supervisory controls.

- **Testing and Verification Required by NASD Rule 3012.** Marc Menchel, Executive Vice President and General Counsel of FINRA, described Rule 3012 as one of the most “contentious” and “misunderstood” rules in the NASD Manual. Rule 3012 requires, among other things, that member firms establish, maintain and enforce a system of supervisory control policies and procedures that test and verify that the firm’s supervisory policies and procedures are reasonably designed to achieve compliance with applicable rules and regulations. This requirement is distinct from firms’ obligations to establish, maintain and enforce a supervisory system and written procedures under Rule 3010. Mr. Menchel stated that there are a number of ways firms can go about satisfying their Rule 3012 requirements. The panelists also suggested certain tips for complying with Rule 3012, including:
 - Maintaining a separate file for materials relating to each of the NASD rules relating to supervision (NASD Rules 3010, 3012 and 3013);
 - Ensuring that persons performing the testing communicate with the business units to understand what they are doing and why;
 - Ensuring that the testing involves a risk-based analysis that takes into account, for example, issues identified by customer complaints, internal and external audits, and industry sweep examinations; and
 - Creating and using a grid or checklist to identify and analyze supervisory controls.
- **The Limited Resources Exception to Rule 3012.** The panelist underscored that this exception only applies to a small part of Rule 3012 – the requirement that producing managers be supervised by an independent person. The panelists stressed that if a firm claims this exception, it should clearly document its basis for doing so.
- **Examination Findings Relating to Supervisory Controls.** Robert Errico, Executive Vice President, Member Regulation, stated that, in general, FINRA has been working with firms to improve their Rule 3012 policies and procedures (instead of referring cases to Enforcement). He cited several examples of deficiencies noted in recent examinations relating to Rule 3012, including:
 - Failing to distinguish between the supervisory control system and written supervisory procedures;
 - Failing to designate a principal to oversee the supervisory system;

- Failing to do annual testing and verification;
- Failing to adequately supervise producing branch managers;
- Failing to prepare and timely submit the report;
- Failing to verify customer changes of address; and
- Failing to review and monitor third-party wires.

Developing Written Supervisory Procedures

The panel led an interactive discussion focusing on how firms should create and modify written supervisory procedures. The following were among the issues discussed:

- Procedures are often created or modified in response to external events, such as press releases, regulatory developments, legal developments, articles, or business changes.
- Procedures need to reflect what firms and individuals are actually doing.
- Procedures are “living” documents; they are constantly changing.
- How often firms update procedures; some firms update their procedures on a regular periodic basis (e.g., every month or quarter), while others update as necessary.
- How revised procedures are disseminated (e.g., hard copies, through email, on a firm’s website).
- Other documents may need to be created or revised when procedures are changed (e.g., internal forms, checklists, new account forms).
- Whether to address senior issues in written supervisory procedures. While it may not be necessary to include age-specific procedures, it may make sense to include a section on senior designations.

For additional information about senior designations, please see:

- 1) FINRA Regulatory Notice 07-43, available [here](#); and
- 2) Sutherland’s Legal Alert titled, “Sutherland to Host Conference Calls on FINRA Sweep Examination of the Use of Professional Designations Involving Seniors and Retirees,” available [here](#).

Anti-Money Laundering

This panel included representatives from FINRA Enforcement, FINRA Member Regulation, the Federal Bureau of Investigation and the industry and discussed how firms can meet their anti-money laundering (“AML”) monitoring obligations. The panel provided specific “how to” advice for firms regarding: (a) establishing an effective, risk-based AML program; (b) identifying red flags of potential suspicious activities; and (c) writing an effective suspicious activity report (“SAR”). In addition, the panel discussed recent AML examination findings.

(1) Establishing an Effective, Risk-Based AML Program

The panel focused on the following issues relating to establishing an effective AML program: (a) identifying client risk; (b) identifying product risk; and (c) ensuring that the program is adequately audited.

- **Identifying Client Risk.** The panel stressed that geography is only one of the factors that should be taken into consideration in assessing client risk. Other “know your customer” factors should also be taken into account, including client net worth and employment. In addition, firms should monitor for clients who are acting inconsistently with their profiles.
- **Identifying Product Risk.** The panel indicated that risk should also be evaluated at the product level. Michael Ruffino, Senior Vice President, FINRA Member Regulation, stated that he is a big proponent of securing “buy-in” from the business lines, noting that they are the experts on their products. An industry panelist noted that his firm requires each line of business to complete an annual self-assessment questionnaire. The questionnaire asks for information about various issues relating to anti-money laundering, including customer identification and acceptance, high-risk customers, customer monitoring, and training.
- **Ensuring an Adequate AML Audit.** An industry panelist stated that an effective AML audit program should include, among other things: (1) a risk assessment; (2) a review of the firm’s policies, procedures and controls, including those related to new accounts (e.g., Customer Identification Program (“CIP”) procedures), SARs, and Office of Foreign Assets Control (“OFAC”) procedures; (3) comprehensive independent testing; (4) adequate training; (5) proper reporting; (6) sufficient record retention and documentation; and (7) appropriate follow-up and corrective action.

The panelists highlighted comprehensive independent testing as a key element of an effective AML audit program. The panel stressed that such testing should be performed by persons independent from the compliance function who have sufficient resources and knowledge of AML issues. In addition, such independent testing should include, for example, a review of the firm’s transaction monitoring system and risk-based testing of client files, accounts and transactions. One panelist stressed that even low-risk client accounts should be reviewed to some degree to ensure that the accounts are, in fact, low risk.

(2) Red Flags of Suspicious Activities

The panel indicated that generally firms should view the following types of activities as potentially suspicious: (1) activity that serves no apparent business purpose; (2) activity that is inconsistent with normal business activity; and (3) activity that appears to be designed to avoid regulatory information gathering or reporting requirements. An industry panelist specifically identified several categories of potential suspicious activity red flags, including the following:

- **Account Opening Issues.** Firms should be suspicious of call-in or walk-in clients with significant assets, particularly if the client makes contact the day before a long weekend. In addition, firms should follow-up on clients who claim they were referred by another client and flag any unconfirmed or inadequately confirmed referrals.
- **ATM Card Use.** Firms should note abnormal ATM card use, particularly use of an ATM card in a country of concern (e.g., a country of known terrorist activity).
- **Concerns about Identity Documents.** Firms should look for, among other things, identity documents issued by a country other than the customer’s country of birth and identity documents from obsolete countries (e.g., U.S.S.R.).

- **Concerns about Foreign Entities Structures.** Firms should note, among other things, if an entity is a bearer share corporation and if the entity's country of incorporation is different from its country of domicile.
- **Deposit Activity.** Firms should identify changes in the makeup or frequency of a customer's deposits.
- **Employment Issues.** Firms should note, among other things, if a client is unwilling to provide specifics of their employment or business, particularly if the client describes herself as self-employed or employed by a family business.
- **Physical Certificates.** Because physical certificates pose special risks (including heightened risks of forgery and fraud), firms should pay particular attention to the adequacy of the certificate itself and the related account activity.
- **Signatory Authority Issues.** Firms should flag accounts where several persons have signature authority over the same account(s), yet those persons appear to have no familial or business relationship.
- **Transaction Activity.** Firms should note, among other things, a concentration of transaction activity in a short time period that moves the price of the security.
- **Unusual Account Activity.** Firms should be suspicious of, among other things, (a) clients who change their address and/or name within the first month of the relationship and engage in activity; and (b) accounts opened by an entity that has the same address as other entities or organizations where the same person or persons have signature authority, and there is no apparent reason for such an arrangement.
- **Wire Activity.** Firms should monitor wire transfer activity to identify, among other things, wire transfers ordered in small amounts to avoid identification or reporting requirements and unusual wire transfers (including, for example, "mistakes" or "reversals of decision" where the funds go to a third party or different location).

(3) Writing an Effective SAR

Kathleen Queally, Special Agent with the Federal Bureau of Investigation, addressed how to write a clear and concise SAR. She stated that generally SARs should be easy to read and contain specific and complete information. She provided the following practical tips:

- Begin with a description of the suspicious activity.
- Do not include disclaimers.
- Do not use technical jargon or abbreviations.
- Explain the source(s) of the information provided.
- Identify the agencies notified concerning the suspicious activity.
- Include a detailed description of the confession, if applicable.
- Include any internal reference numbers.
- Include the full dates of all relevant events.

- Identify related accounts, where applicable.
- Reference any relevant prior SAR filings.

(4) AML Examination Findings

Michael Ruffino, Senior Vice President, FINRA Member Regulation, summarized the deficiencies found by FINRA examinations relating to AML. Specifically, he indicated that FINRA found deficiencies in the following areas:

- **AML Programs.** Deficiencies found included inadequate exception reporting; failure to adhere to the firm's own policies and procedures; and failure to adequately review wire transfers and/or intra-account journals.
- **Bearer Share Accounts.** Deficiencies found included failure to develop policies and procedures for monitoring and supervising bearer share accounts.
- **CIP.** Deficiencies found included failure to identify and verify customer identity, failure to question discrepancies on information received, failure to use readily available public information, and failure to code accounts with common ownership.
- **Foreign Bank Certifications.** Deficiencies found included failure to identify foreign banks under Sections 313/319 of the USA PATRIOT Act.
- **Identifying and Reporting Suspicious Activity.** Deficiencies found included inadequate follow-up on questionable activity; failure to review exception reports on a timely basis; unreasonable reliance on manual reviews of wires and journals; failure to review journals between internal accounts; and late and/or incomplete SAR filings.
- **Independent Testing.** Deficiencies found included failure to ensure independence of auditor, inadequate review scope, failure to follow up on previous year's recommendations, failure to review adequacy of exception reports, and failure to conduct any underlying testing (the "testing" was limited to a review of the firm's policies and procedures).
- **OFAC Issues.** Deficiencies found included failure to check new accounts or third party wires against the OFAC Specially Designated Nationals ("SDN") List, and failure to consider OFAC's Sanctioned Countries.
- **Outsourcing.** Deficiencies found included failure to ensure that testing performed by third-party vendors and consultants was independent and adequate in scope. For example, one firm's testing was found to be deficient because it was performed by the same vendor that wrote the firm's AML program.
- **Section 314(a) of the USA PATRIOT Act.** Deficiencies found included failure to update 314(a) contact information and failure to demonstrate that a search was completed in a timely manner.
- **Special Measures under Section 311 of the USA PATRIOT Act.** Deficiencies found included AML programs that failed to address the requirement to comply with special measures or the requirement to send notifications to correspondent account holders.

- **Training.** Deficiencies found included failure to provide AML training, failure to ensure that all persons required to receive AML training actually did, and failure to maintain adequate records of AML training.

Ask FINRA Staff

This session provided conference participants the unique opportunity to ask anonymous questions of FINRA senior officials. Below are summaries of some of the more interesting issues raised during this session.

- **Consolidated Rulebook.** Grace Vogel, Senior Vice President and Corporate Secretary, stated that in consolidating NASD's and NYSE's rulebooks, FINRA is considering tiering certain rules in recognition of the diversity in the broker-dealer industry.
- **Examination Issues.** Ms. Vogel and Robert Errico, Executive Vice President, Member Regulation, identified the following hot examination issues: back office operations and controls, outsourcing arrangements, direct market access arrangements, data security and data privacy, anti-money laundering, business continuity plans, new products and electronic communications.
- **Fifth Amendment Issues.** Susan Merrill, Executive Vice President and Chief of Enforcement, stated that the Fifth Amendment does not apply to FINRA; therefore, persons cannot refuse to give testimony to FINRA based on the Fifth Amendment privilege. However, Ms. Merrill noted that FINRA does not bring enforcement actions against persons who refuse to give testimony reflexively and is willing, in certain circumstances, to consider other avenues for obtaining the information needed or delaying the investigation until the criminal matter has concluded.
- **Guidance on Rule 2821.** New Rule 2821, which was recently approved by the SEC, will apply to deferred variable annuity purchases and exchanges and will establish new suitability and supervision requirements for such transactions. Elisse Walter, Senior Executive Vice President, Regulatory Policy & Programs, stated that FINRA has until November 7, 2007, to issue a notice on Rule 2821. FINRA has drafted the notice, and it is virtually complete; however, FINRA will likely wait to release the notice until closer to the November 7 deadline. Rule 2821 will become effective six months after that notice is published.
- **Hedge Fund Affiliated Broker-Dealers.** Ms. Vogel indicated that FINRA is pursuing a special examination of broker-dealers affiliated with hedge funds. That examination is looking at the following issues, among others: conflicts of interest, cherry picking in allocations, front running, and the pricing of securities.
- **Professional Designations.** Ms. Merrill stated that FINRA would not approve or reject any particular professional designation. She stressed that FINRA views designations to be false and misleading if they convey an expertise in senior investing, but were obtained without any examination or education. Member firms should establish and maintain policies and procedures governing the use of professional designations.
- **Publication of Sweep Examination Letters.** In response to a question submitted by Brian Rubin of Sutherland Asbill & Brennan, Daniel Sibears, Senior Vice President and Deputy, Market Regulation, stated that the staff is cognizant of the potential value of making sweep examination letters publicly available so that firms not subject to the sweep are aware of the issues and can review their own policies and procedures for those issues. He indicated that the staff would take that suggestion under advisement.

- **Sales to Military Personnel.** James Shorris, Executive Vice President and Executive Director of Enforcement, stated that sales to military personnel is an area of continuing interest to FINRA. In particular, FINRA is concerned about systematic investment plans, liquidity issues and lack of sophistication. Ms. Walter noted that FINRA launched an investor education plan for military persons.
- **You Tube Postings.** Thomas Selman, Senior Vice President, FINRA Investment Companies/Corporate Financing, stated that You Tube postings by registered persons are considered communications with the public and are therefore subject to NASD rules.

Broker-Dealer and Investment Adviser Issues

This panel was dedicated to issues effecting dual broker-dealer and investment adviser registrants. The panel primarily focused on two issues: examinations and the D.C. Circuit decision overturning the *Merrill Lynch* rule in *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007).

(1) Examinations

The panel discussed (1) the findings of NASAA's coordinated examinations of investment advisers, and (2) potential overlap between FINRA examinations and investment adviser issues.

- **NASAA's Coordinated Examinations of Investment Advisers.** NASAA led a nationwide series of coordinated investment adviser examinations by 43 state and provincial securities examiners. The top deficiencies identified by these examinations involved:
 - Registration issues (including, for example, failing to amend Form ADV in a timely manner);
 - Unethical business practices (including, for example, unsuitable recommendations, excessive fees, and contract deficiencies);
 - Books and records (including, for example, failure to maintain suitability data and financials);
 - Supervisory and compliance deficiencies (including, for example, failure to have written policies and procedures); and
 - Privacy deficiencies (including, for example, failure to establish a privacy policy and failure to provide privacy notices).

For additional information about NASAA's examinations and to view a list of "best practice" recommendations based on NASAA's examinations, please click [here](#).

- **Potential Overlap with FINRA Examinations.** Joseph McCarthy, Vice President and Western Regional Director, stated that FINRA's examinations would not focus on advisory accounts because FINRA does not have jurisdiction over such accounts. However, he indicated that it is possible that FINRA examinations may touch on investment adviser issues. For example, when FINRA examiners are reviewing a sample of transactions, transactions in advisory accounts may be included. In addition, FINRA may review customer complaints, advertisements or electronic communications that contain information about investment advisers and/or advisory accounts.

(2) Financial Planning Association v. SEC

Mr. Selman discussed the background of the *Merrill Lynch* rule and the D.C. Circuit's decision to overturn it in *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007). He stated that the SEC

chose not to appeal the decision and also chose not to re-write the *Merrill Lynch* rule. Instead, the SEC took what Mr. Selman described as a middle ground approach; it proposed temporary rule 206(3)-3T to address one of the chief concerns with the application of the Investment Advisers Act of 1940 (the "Advisers Act") to broker-dealers – the principal trading restriction of Section 206(3).

Prior to Rule 206(3)-3T, to execute a principal trade (e.g., to trade out of inventory), an investment adviser needed to provide the client written disclosure and obtain client consent. Recognizing that requirement as impractical for wirehouses, the SEC adopted Rule 206(3)-3T, which prescribes an alternative disclosure framework for principal trades executed on a non-discretionary basis by a dually registered broker-dealer/investment adviser. Under the rule, such firms may satisfy the principal trade disclosure requirement by:

- Providing a one-time written notification to clients that (1) states that the firm may engage in principal trading with the client, (2) discloses any related conflicts of interest, (3) indicates how those conflicts are addressed by the firm, and (4) advises the client that she can revoke her consent to principal trading at any time without penalty;
- Disclosing to the client at the time of each trade that the firm may trade with the client on a principal basis and obtaining the client's consent to that trade;
- Indicating on the trade confirmation that the firm acted as a principal in the trade with the client and that the client consented to the principal trade; and
- Providing the client an annual list of all principal trades effected in their accounts during the previous year.

Temporary Rule 206(3)-3T expires on December 31, 2009, at which time the SEC intends to reevaluate the landscape in light of the study conducted by RAND Corporation, which is expected to be released later this year. To view the adopting release for Rule 206(3)-3T, please click [here](#).

For additional information about the D.C. Circuit's decision in *Financial Planning Association v. SEC*, please see:

Eric A. Arnold and Michael B. Koffler, Whither Fee-Based Accounts: The DC Circuit Vacates Investment Advisers Act Rule 202(A)(11)-1, 14 THE INVESTMENT LAWYER No. 6 (2007).

[New Products: Regulatory and Compliance Considerations](#)

This panel addressed firms' obligations with respect to new products, both pre-launch and post-launch, including the requirement that firms develop procedures for the vetting of new products. The panel discussed various issues, including how to define a new product, who should review new products, how to vet a new product, and post-launch obligations for new products.

- **Defining a New Product.** New products can include, for example, a new product developed internally at a firm, a new product transferred to a firm by a new recruit, and materially significant changes to existing products. Eric Moss, Vice President and Director, FINRA Office of Emerging Regulatory Issues, stated that if firms are unclear, they should err on the side of treating a product as a new product. He also noted that if a product is new to a firm, the firm should treat it as a new product, regardless of whether other firms are selling the product.
- **Who Should Review New Products.** Industry panelists suggested that firms create a committee for reviewing new products. Depending on the firm, the committee can include individuals from

the appropriate business unit, operations, the law department, the compliance department, internal audit, and others.

- **Vetting New Products.** Mr. Moss stated that firms should develop a standardized process for the submission and vetting of new products. He further stressed the importance of ensuring that the right questions are asked about new products. For example, firms must consider the target customers for the new products and the costs and fees associated with the new product. Firms should ensure that the new product vetting process is well-documented. The industry panelists suggested that firms create a new product review checklist and require that the checklist be completed by the submitter of each new product. For additional guidance on the vetting of new products, please see NASD Notice to Members 05-26, available [here](#).
- **Post Product Launch Obligations.** The panel noted that a firm's obligations with respect to a new product do not end when the product is launched. Instead, firms should back test products to ensure that they are performing as intended. In addition, firms should consider red flags of potential inadequate training with respect to the new product, including, for example, customer complaints.



If you have any questions about the FINRA Fall Securities Conference, or the services we provide, please feel free to contact Brian Rubin (brian.rubin@sablaw.com), Shanyn Gillespie (shanyn.gillespie@sablaw.com) or any of the partners on our Securities Enforcement or Financial Services teams.

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