

### **SEC TO FINRA: IMPROVE INTERNAL COMPLIANCE POLICIES AND PROCEDURES**

In response to Financial Industry Regulatory Authority (“FINRA”) producing altered and inaccurate documents during a 2008 inspection, the Securities and Exchange Commission (“SEC”) issued an order on October 27, 2011 directing FINRA to hire an independent consultant to support a reassessment of its document production policies and procedures. As highlighted in the SEC release by Gerald Hodgkins, Associate Director of the SEC’s Division of Enforcement, “The law requires FINRA to produce the documents the SEC seeks in its examinations in complete and accurate form.” While FINRA responded with internal policy changes in light of its malfeasance, Hodgkins confirmed “those enhancements did not go far enough to prevent the document production failure that occurred in its Kansas City District Office. This order [for independent consultant support] will help ensure that FINRA effectively addresses the weaknesses in its training as well as its policies and procedures.”

FINRA is currently responsible for overseeing securities brokers and issuing fines for unauthorized trades, falsifying records, or deserving offenses. “As a regulator, FINRA must always hold itself to the highest standards,” said FINRA CEO Richard Ketchum. “When we discover shortcomings, it is our obligation to take appropriate corrective action and make it clear that we have zero tolerance for actions that could compromise the integrity of our organization.” While neither admitting nor denying the SEC’s findings, FINRA consented to the cease-and-desist order, committing to ensure future violations of Section 17(a) of the Securities Exchange Act of 1934 and Exchange Act Rule 17a-1 do not occur.

### **FINRA ISSUES GUIDANCE REGARDING REGULATION OF ETFs AND TIPS ADVERTISING**

On October 27, 2011, FINRA issued guidance regarding National Association of Securities Dealers (“NASD”) Rule 2210 to firms engaged in the sale of exchange-traded funds (“ETFs”) and Treasury Inflation-Protected Securities (“TIPS”). NASD Rule 2210 The rule requires firms to file all advertisements, sales literature and certain ETF research reports regulated under the Investment Company Act of 1940.

Citing concern with the current yield calculation used by mutual funds, FINRA interprets NASD Rule 2210 to funds investing in TIPS to include current yield calculations in their advertising and sales materials. Different firms calculate current yield differently, with some methodologies adjusting for inflation. When including high yields, the fund must disclose whether inflation was accounted for in the calculation. “FINRA is concerned that investors may not understand that these differences in advertised yield are largely attributable to the different methods used to calculate current yield, rather than differences in performance of the funds themselves,” states the guidance. Including high yields, the fund must disclose whether inflation was accounted for in the calculation. “FINRA is concerned that investors may not understand that these differences in advertised yield are largely attributable to the different methods used to calculate current yield, rather than differences in performance of the funds themselves,” states the guidance. Regarding ETFs, FINRA further reminded funds to file all research reports encompassed in the definition of advertisement or sales materials within 10 business days of publishing information. Lastly, the regulator

### **HIGHLIGHTS**

The SEC ordered FINRA to hire an independent consultant to reassess its document production policies and procedures

FINRA issued guidance regarding NASD Rule 2210 and the sale of ETFs

Daniel Gallagher was sworn in as SEC Commissioner

The SEC intends to release a proposal to regulate MMfs in the next four months

reaffirmed NASD IM-2210-4, prohibiting all use of FINRA trademarks and references to FINRA memberships in such communications.

### **DANIEL GALLAGHER SWORN IN AS SEC COMMISSIONER**

On November 7, 2011, Daniel E. Gallagher returned to the SEC in his new role as SEC Commissioner. "I am extraordinarily excited to have the opportunity to return to the Commission at such a critical time for both investors and the securities markets," said Commissioner Gallagher. "I look forward to working with my fellow Commissioners and the remarkable staff of the agency as we strive to protect investors, maintain fair and efficient markets, and promote capital formation."

Commissioner Gallagher began at the SEC in January 2006, serving first as counsel to Commissioner Paul Atkins and later to Chairman Christopher Cox. During this time, Commissioner Gallagher worked closely with the Division of Trading and Markets and the Division of Enforcement. Commissioner Gallagher later joined the Division of Trading and Markets as a Deputy Director in 2008. During this period he focused on issues relating to credit agencies and credit default swaps. Before leaving for private practice in January 2010, Commissioner Gallagher served as Co-Acting Director of the Trading and Markets Division.

### **SEC CHAIRMAN: MONEY-FUND OVERHAUL WITHIN NEXT FOUR MONTHS**

Speaking at the annual Securities Industry and Financial Markets Association conference in Manhattan, SEC Chairman Mary Schapiro advised attendees that the SEC expects to release a proposal to regulate the money-market fund industry within the next four months. To date, the SEC has considered two reform options in response to the September 2008 collapse that saw money market funds fall below the \$1 net asset value that money funds seek to maintain.

According to Chairman Schapiro, the most supported approach to prevent "breaking the buck" would create a "capital buffer" which funds could access to navigate through difficult financial periods. Alternatively, the SEC is also considering implementing a floating net-asset value ("NAV"), a proposal which has been met with criticism by the industry. "I would say we're putting more of our energy into seeing if we can develop a capital buffer structure that would be effective and would allow money-market funds to continue to have a stable NAV," said Chairman Schapiro. "A challenge is how to establish a capital buffer that offers meaningful protection against unexpected events, without over-protecting and unnecessarily interfering with the prudent and efficient portfolio management of the fund." The funding to establish the buffer would ultimately come from a fund's sponsor, its shareholders, or from the market.

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