

*Required fields are shown with yellow backgrounds and asterisks.*

Page 1 of * <input type="text" value="26"/>	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - <input type="text" value="2012"/> - * <input type="text" value="021"/> Amendment No. (req. for Amendments *) <input type="text"/>
Proposed Rule Change by NASDAQ Stock Market Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934		
Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>
Section 19(b)(2) * <input type="checkbox"/>		Section 19(b)(3)(A) * <input checked="" type="checkbox"/>
Section 19(b)(3)(B) * <input type="checkbox"/>		Section 19(b)(3)(B) * <input type="checkbox"/>
Rule		
Pilot <input type="checkbox"/>		<input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(4)
Extension of Time Period for Commission Action * <input type="text"/>		<input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(5)
Date Expires * <input type="text"/>		<input type="checkbox"/> 19b-4(f)(3) <input checked="" type="checkbox"/> 19b-4(f)(6)
Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>	
<b>Description</b> Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked *). <input type="text" value="Fidelity Bonds"/>		
<b>Contact Information</b> Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change. First Name * <input type="text" value="Angela"/> Last Name * <input type="text" value="Dunn"/> Title * <input type="text" value="Associate General Counsel"/> E-mail * <input type="text" value="Angela.dunn@nasdaqomx.com"/> Telephone * <input type="text" value="(215) 496-5692"/> Fax <input type="text"/>		
<b>Signature</b> Pursuant to the requirements of the Securities Exchange Act of 1934,  has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer. Date <input type="text" value="01/31/2012"/> By <input type="text" value="Edward S. Knight"/> Executive Vice President and General Counsel (Name *) (Title *)  NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed. <input type="button" value="Edward S Knight"/>		

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

**Form 19b-4 Information (required)**

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change (required)**

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> the NASDAQ Stock Market LLC (“NASDAQ” or the “Exchange”) is filing with the Securities and Exchange Commission (“Commission”) a proposed rule change to amend NASDAQ Rule 3020 to reflect recent changes to a corresponding rule of the Financial Industry Regulatory Authority (“FINRA”).

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1 and the text of the proposed Rule is attached hereto as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by senior management of NASDAQ pursuant to authority delegated by the Board of Directors of NASDAQ on August 19, 2011. NASDAQ staff will advise the Board of Directors of NASDAQ of any action taken pursuant to delegated authority. No other action by NASDAQ is necessary for the filing of the rule change.

Questions regarding this rule filing may be directed to Angela Saccomandi Dunn, Assistant General Counsel, at (215) 496-5692.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

a. Purpose

Many of NASDAQ's rules are based on rules of FINRA (formerly the National Association of Securities Dealers ("NASD")). Beginning in 2008, FINRA embarked on an extended process of moving rules formerly designated as "NASD Rules" into a consolidated FINRA rulebook. In most cases, FINRA has renumbered these rules, and in some cases has substantively amended them. Accordingly NASDAQ also has initiated a process of modifying its rulebook to ensure that NASDAQ rules corresponding to FINRA/NASD rules continue to mirror them as closely as practicable.

This proposed rule change concerns NASDAQ Rule 3020 entitled "Fidelity Bonds," which follows and incorporates by reference former NASD Rule 3020.<sup>3</sup> FINRA recently amended its rules to adopt former NASD Rule 3020, relating to Fidelity Bonds, with certain changes, into the consolidated FINRA rulebook as FINRA Rule 4360.<sup>4</sup> NASDAQ Rule 3020 provides that a "A member designated to Nasdaq for oversight pursuant to SEC Rule 17d-1 shall comply with NASD Rule 3020 as if such Rule were part of Nasdaq's Rules." The Exchange proposes to amend this text to reference new FINRA Rule 4360, which replaced NASD Rule 3020.

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<sup>3</sup> The purpose of the fidelity bond is to protect a member against certain types of losses, including, but not limited to, those caused by the malfeasance of its officers and employees, and the effect of such losses on the member's capital.

<sup>4</sup> See Securities Exchange Act Release No. 63961 (February 24, 2011), 76 FR 11542 (March 2, 2011) (SR-FINRA-2010-059) (a rule change to adopt a rule of the National Association of Securities Dealers, Inc. ("NASD") as part of the consolidation of the FINRA rulebook). This new rule took into account Incorporated NYSE Rule 319 (Fidelity Bonds) and its Interpretation.

NASD Rule 3020(a) generally provides that each member required to join the Securities Investor Protection Corporation ("SIPC") that has employees and that is not a member in good standing of one of the enumerated national securities exchanges must maintain fidelity bond coverage. FINRA Rule 4360 requires each member that is required to join SIPC to maintain blanket fidelity bond coverage with specified amounts of coverage based on the member's net capital requirement, with certain exceptions. NASD Rule 3020(a)(1) requires members to maintain a blanket fidelity bond in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America. New FINRA Rule 4360 requires members to maintain fidelity bond coverage that provides for per loss coverage without an aggregate limit of liability. Also, pursuant to FINRA Rule 4360, a member's fidelity bond must provide against loss and have Insuring Agreements covering at least the following: Fidelity, on premises, in transit, forgery and alteration, securities and counterfeit currency. The rule change modified the descriptive headings for these Insuring Agreements, in part, from NASD Rule 3020(a)(1) and NYSE Rule 319(d) to align them with the headings in the current bond forms available to broker-dealers. FINRA Rule 4360 also eliminates the specific coverage provisions in NASD Rule 3020(a)(4) and (a)(5), and NYSE Rule 319(d)(ii)(B) and (C), and (e)(ii)(B) and (C), that permit less than 100 percent of coverage for certain Insuring Agreements (*i.e.*, fraudulent trading and securities forgery) to require that coverage for all Insuring Agreements be equal to 100 percent of the firm's minimum required bond coverage.<sup>5</sup>

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<sup>5</sup> Members may elect to carry additional, optional Insuring Agreements not required by FINRA Rule 4360 for an amount less than 100 percent of the minimum required bond coverage.

Further, FINRA Rule 4360 requires that a member's fidelity bond include a cancellation rider providing that the insurer will use its best efforts to promptly notify FINRA in the event the bond is cancelled, terminated or "substantially modified." Also, the rule change adopted the definition of "substantially modified" in NYSE Rule 319 and would incorporate NYSE Rule 319.12's standard that a firm must *immediately* advise FINRA in writing if its fidelity bond is cancelled, terminated or substantially modified.<sup>6</sup> FINRA added supplementary material to FINRA Rule 4360 requiring members that do not qualify for a bond with per loss coverage without an aggregate limit of liability to secure alternative coverage. Specifically, a member that does not qualify for blanket fidelity bond coverage as required by FINRA Rule 4360(a)(3) is required to maintain substantially similar fidelity bond coverage in compliance with all other provisions of the rule, provided that the member maintains written correspondence from two insurance providers stating that the member does not qualify for the coverage required by FINRA Rule 4360(a)(3).

FINRA Rule 4360 requires each member to maintain, at a minimum, fidelity bond coverage for any person associated with the member, except directors or trustees of a member who are not performing acts within the scope of the usual duties of an officer or employee. As further detailed below, the rule change eliminated the exemption in NASD Rule 3020 for sole stockholders and sole proprietors. The rule change also increased the minimum required fidelity bond coverage for members, while continuing to base the coverage on a member's net capital requirement. To that end, FINRA Rule 4360 required

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<sup>6</sup> NYSE Rule 319 defines the term "substantially modified" as any change in the type or amount of fidelity bonding coverage, or in the exclusions to which the bond is subject, or any other change in the bond such that it no longer complies with the requirements of the rule.

a member with a net capital requirement that is less than \$250,000 to maintain minimum coverage of the greater of 120 percent of the firm's required net capital under Exchange Act Rule 15c3-1 or \$100,000. The increase to \$100,000 modifies the present minimum requirement of \$25,000.

Under the new FINRA Rule 4360, members with a net capital requirement of at least \$250,000 must use a table in the rule to determine their minimum fidelity bond coverage requirement. The table is a modified version of the tables in NASD Rule 3020(a)(3) and NYSE Rule 319(e)(i). The identical NASD and NYSE requirements for members that have a minimum net capital requirement that exceeds \$1 million are retained in the new Rule; however, the rule adopts the higher requirements in NYSE Rule 319(e)(i) for a member with a net capital requirement of at least \$250,000, but less than \$1 million. Under the new rule, the entire amount of a member's minimum required coverage must be available for covered losses and may not be eroded by the costs an insurer may incur if it chooses to defend a claim. Specifically, any defense costs for covered losses must be in addition to a member's minimum coverage requirements. A member may include defense costs as part of its fidelity bond coverage, but only to the extent that it does not reduce a member's minimum required coverage under the rule.

Under prior NASD Rule 3020(b), a deductible provision may be included in a member's bond of up to \$5,000 or 10% of the member's minimum insurance requirement, whichever is greater. If a member desires to maintain coverage in excess of the minimum insurance requirement, then a deductible provision may be included in the bond of up to \$5,000 or 10% of the amount of blanket coverage provided in the bond purchased, whichever is greater. The excess of any such deductible amount over the maximum

permissible deductible amount based on the member's minimum required coverage must be deducted from the member's net worth in the calculation of the member's net capital for purposes of Exchange Act Rule 15c3-1. Where the member is a subsidiary of another member, the excess may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.<sup>7</sup> FINRA Rule 4360 provides for an allowable deductible amount of up to 25% of the fidelity bond coverage purchased by a member. Any deductible amount elected by the firm that is greater than 10% of the coverage purchased by the member<sup>8</sup> would be deducted from the member's net worth in the calculation of its net capital for purposes of Exchange Act Rule 15c3-1.<sup>9</sup> Like the NASD and NYSE rules, if the member is a subsidiary of another FINRA member, this amount may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

Consistent with NASD Rule 3020(c) and NYSE Rule 319.10, FINRA Rule 4360 requires a member (including a firm that signs a multi-year insurance policy), annually as

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<sup>7</sup> Under NYSE Rule 319(b), each member organization may self-insure to the extent of \$10,000 or 10% of its minimum insurance requirement as fixed by the NYSE, whichever is greater, for each type of coverage required by the rule. Self-insurance in amounts exceeding the above maximum may be permitted by the NYSE provided the member or member organization certifies to the satisfaction of the NYSE that it is unable to obtain greater bonding coverage, and agrees to reduce its self-insurance so as to comply with the above stated limits as soon as possible, and appropriate charges to capital are made pursuant to Exchange Act Rule 15c3-1. This provision also contains identical language to the NASD rule regarding net worth deductions for subsidiaries.

<sup>8</sup> FINRA notes that a member may elect, subject to availability, a deductible of less than 10 percent of the coverage purchased.

<sup>9</sup> NASD Rule 3020 bases the deduction from net worth for an excess deductible on a firm's minimum required coverage, while FINRA Rule 4360 would base such deduction from net worth on coverage *purchased* by the member.



of the yearly anniversary date of the issuance of the fidelity bond, to review the adequacy of its fidelity bond coverage and make any required adjustments to its coverage, as set forth in the rule. Under FINRA Rule 4360(d), a member's highest net capital requirement during the preceding 12-month period, based on the applicable method of computing net capital (dollar minimum, aggregate indebtedness or alternative standard), is used as the basis for determining the member's minimum required fidelity bond coverage for the succeeding 12-month period. The "preceding 12-month period" includes the 12-month period that ends 60 days before the yearly anniversary date of a member's fidelity bond. This would give a firm time to determine its required fidelity bond coverage by the anniversary date of the bond.

Further, FINRA Rule 4360 allows a member that has only been in business for one year and elected the aggregate indebtedness ratio for calculating its net capital requirement to use, solely for the purpose of determining the adequacy of its fidelity bond coverage for its second year, the 15 to 1 ratio of aggregate indebtedness to net capital in lieu of the 8 to 1 ratio (required for broker-dealers in their first year of business) to calculate its net capital requirement. Notwithstanding the above, such member would not be permitted to carry less minimum fidelity bond coverage in its second year than it carried in its first year.

Based in part on NASD Rule 3020(a), FINRA Rule 4360 exempts from the fidelity bond requirements members in good standing with a national securities exchange that maintain a fidelity bond subject to the requirements of such exchange that are equal to or greater than the requirements set forth in Rule 4360. Additionally, consistent with NYSE Rule Interpretation 319/01, FINRA Rule 4360 continues to exempt from the

fidelity bond requirements any firm that acts solely as a Designated Market Maker ("DMM"),<sup>10</sup> floor broker or registered floor trader and does not conduct business with the public. FINRA Rule 4360 does not maintain the exemption in NASD Rule 3020(e) for a one-person firm.<sup>11</sup> Historically, a sole proprietor or sole stockholder member was excluded from the fidelity bond requirements based upon the assumption that such firms were one-person shops and, therefore, could not obtain coverage for their own acts. FINRA has determined that sole proprietors and sole stockholder firms can and often do acquire fidelity bond coverage, even though it is currently not required, since all claims (irrespective of firm size) are likely to be paid or denied on a facts-and-circumstances basis. Also, certain coverage areas of the fidelity bond benefit a one-person shop (*e.g.*, those covering customer property lost in transit).

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>12</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>13</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove

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<sup>10</sup> See Exchange Act Release No. 58845 (Oct. 24, 2008), 73 FR 64379 (Oct. 29, 2008) (Order Approving File No. SR-NYSE-2008-46). In this rule filing, the role of the specialist was altered in certain respects and the term "specialist" was replaced with the term "Designated Market Maker."

<sup>11</sup> A one-person member (that is, a firm owned by a sole proprietor or stockholder that has no other associated persons, registered or unregistered) has no "employees" for purposes of NASD Rule 3020, and therefore such a firm currently is not subject to the fidelity bonding requirements. Conversely, a firm owned by a sole proprietor or stockholder that has other associated persons has "employees" for purposes of NASD Rule 3020, and currently is, and will continue to be, subject to the fidelity bonding requirements.

<sup>12</sup> 15 U.S.C. 78f(b).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest, by updating and clarifying the requirements governing fidelity bonds. The Exchange believes that the proposed requirements of Rule 4360, including, but not limited to, requiring each member that is required to join SIPC to maintain blanket fidelity bond coverage, increasing the minimum requirement fidelity bond coverage and maintaining a fidelity bond that provides for per loss coverage without an aggregate limit of liability promotes investor protection by protecting firms from unforeseen losses. The proposed amendments will conform NASDAQ Rule 3020 to recent changes made to a corresponding FINRA rule, to promote application of consistent regulatory standards.

4. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time period for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Pursuant to Section 19(b)(3)(A) of the Act<sup>14</sup> and Rule 19b-4(f)(6)<sup>15</sup> thereunder,

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<sup>14</sup> 15 U.S.C. 78s(b)(3)(A).

the Exchange has designated this proposal as one that effects a change that: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest.

In its guidance on the proposed rules of Self-Regulatory organizations (“SROs”),<sup>16</sup> the Commission concluded that filings based on the rules of another SRO already approved by the Commission are eligible for immediate effectiveness under Rule 19b-4(f)(6). The Commission noted that “a proposed rule change appropriately may be filed as an immediately effective rules so long as it is based on and similar to another SRO’s rule and each policy issue raised by the proposed rule (i) has been considered previously by the Commission when the Commission approved another exchange’s rule (that was subject to notice and comment), and (ii) the rule change resolved such policy issue in a manner consistent with such prior approval.”<sup>17</sup> The Exchange notes that the amendment to the NASDAQ Rule will require compliance of a recently approved rule change by FINRA.

Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement. Furthermore, a proposed rule

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<sup>15</sup> 17 CFR. 240.19b-4(f)(6).

<sup>16</sup> See Securities Exchange Act Release No. 58092 (July 3, 2008), 73 FR 40144 (July 11, 2008).

<sup>17</sup> Id. at 40149.

change filed pursuant to Rule 19b-4(f)(6) under the Act<sup>18</sup> normally does not become operative for 30 days after the date of its filing. However, Rule 19b-4(f)(6)<sup>19</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange requests that the Commission waive the 30-day operative delay and designate the proposed rule change to become operative upon filing. The Exchange believes that its members are currently subject to FINRA Rule 4360 as the Exchange refers its members to FINRA's rules with respect to fidelity bonds.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposed rule change is based on a rule change by FINRA.<sup>20</sup>

9. Exhibits

1. Notice of proposed rule for publication in the Federal Register.
5. Proposed Rule Text.

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<sup>18</sup> 17 CFR. 240.19b-4(f)(6).

<sup>19</sup> 17 CFR. 240.19b-4(f)(6).

<sup>20</sup> See Securities Exchange Act Release No. 63961 (February 24, 2011), 76 FR 11542 (March 2, 2011) (SR-FINRA-2010-059) (a rule change to adopt a rule of the National Association of Securities Dealers, Inc. ("NASD") as part of the consolidation of the FINRA rulebook). This new rule took into account Incorporated NYSE Rule 319 (Fidelity Bonds) and its Interpretation.

Exhibit 1

SECURITIES AND EXCHANGE COMMISSION  
(Release No. \_\_\_\_\_ ; File No. SR-NASDAQ-2012-021)

January \_\_, 2012

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of  
Proposed Rule Change by NASDAQ Stock Market, LLC Relating to Fidelity Bonds

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup>, and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on January 31, 2012. The NASDAQ Stock Market LLC ("NASDAQ" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the NASDAQ. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The NASDAQ Stock Market LLC proposes to amend NASDAQ Rule 3020 to reflect recent changes to a corresponding rule of the Financial Industry Regulatory Authority ("FINRA").

The text of the proposed rule change is available on the Exchange's Website at <http://www.nasdaq.cchwallstreet.com>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Many of NASDAQ's rules are based on rules of FINRA (formerly the National Association of Securities Dealers ("NASD")). Beginning in 2008, FINRA embarked on an extended process of moving rules formerly designated as "NASD Rules" into a consolidated FINRA rulebook. In most cases, FINRA has renumbered these rules, and in some cases has substantively amended them. Accordingly NASDAQ also has initiated a process of modifying its rulebook to ensure that NASDAQ rules corresponding to FINRA/NASD rules continue to mirror them as closely as practicable.

This proposed rule change concerns NASDAQ Rule 3020 entitled "Fidelity Bonds," which follows and incorporates by reference former NASD Rule 3020.<sup>3</sup> FINRA recently amended its rules to adopt former NASD Rule 3020, relating to Fidelity Bonds, with certain changes, into the consolidated FINRA rulebook as FINRA Rule 4360.<sup>4</sup>

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<sup>3</sup> The purpose of the fidelity bond is to protect a member against certain types of losses, including, but not limited to, those caused by the malfeasance of its officers and employees, and the effect of such losses on the member's capital.

<sup>4</sup> See Securities Exchange Act Release No. 63961 (February 24, 2011), 76 FR 11542 (March 2, 2011) (SR-FINRA-2010-059) (a rule change to adopt a rule of the

NASDAQ Rule 3020 provides that a “A member designated to Nasdaq for oversight pursuant to SEC Rule 17d-1 shall comply with NASD Rule 3020 as if such Rule were part of Nasdaq’s Rules.” The Exchange proposes to amend this text to reference new FINRA Rule 4360, which replaced NASD Rule 3020.

NASD Rule 3020(a) generally provides that each member required to join the Securities Investor Protection Corporation (“SIPC”) that has employees and that is not a member in good standing of one of the enumerated national securities exchanges must maintain fidelity bond coverage. FINRA Rule 4360 requires each member that is required to join SIPC to maintain blanket fidelity bond coverage with specified amounts of coverage based on the member's net capital requirement, with certain exceptions. NASD Rule 3020(a)(1) requires members to maintain a blanket fidelity bond in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America. New FINRA Rule 4360 requires members to maintain fidelity bond coverage that provides for per loss coverage without an aggregate limit of liability. Also, pursuant to FINRA Rule 4360, a member's fidelity bond must provide against loss and have Insuring Agreements covering at least the following: Fidelity, on premises, in transit, forgery and alteration, securities and counterfeit currency. The rule change modified the descriptive headings for these Insuring Agreements, in part, from NASD Rule 3020(a)(1) and NYSE Rule 319(d) to align them with the headings in the current bond forms available to broker-dealers. FINRA Rule 4360 also eliminates the specific coverage provisions in NASD Rule 3020(a)(4) and (a)(5), and NYSE Rule

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National Association of Securities Dealers, Inc. (“NASD”) as part of the consolidation of the FINRA rulebook). This new rule took into account Incorporated NYSE Rule 319 (Fidelity Bonds) and its Interpretation.



319(d)(ii)(B) and (C), and (e)(ii)(B) and (C), that permit less than 100 percent of coverage for certain Insuring Agreements (*i.e.*, fraudulent trading and securities forgery) to require that coverage for all Insuring Agreements be equal to 100 percent of the firm's minimum required bond coverage.<sup>5</sup>

Further, FINRA Rule 4360 requires that a member's fidelity bond include a cancellation rider providing that the insurer will use its best efforts to promptly notify FINRA in the event the bond is cancelled, terminated or "substantially modified." Also, the rule change adopted the definition of "substantially modified" in NYSE Rule 319 and would incorporate NYSE Rule 319.12's standard that a firm must *immediately* advise FINRA in writing if its fidelity bond is cancelled, terminated or substantially modified.<sup>6</sup> FINRA added supplementary material to FINRA Rule 4360 requiring members that do not qualify for a bond with per loss coverage without an aggregate limit of liability to secure alternative coverage. Specifically, a member that does not qualify for blanket fidelity bond coverage as required by FINRA Rule 4360(a)(3) is required to maintain substantially similar fidelity bond coverage in compliance with all other provisions of the rule, provided that the member maintains written correspondence from two insurance providers stating that the member does not qualify for the coverage required by FINRA Rule 4360(a)(3).

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<sup>5</sup> Members may elect to carry additional, optional Insuring Agreements not required by FINRA Rule 4360 for an amount less than 100 percent of the minimum required bond coverage.

<sup>6</sup> NYSE Rule 319 defines the term "substantially modified" as any change in the type or amount of fidelity bonding coverage, or in the exclusions to which the bond is subject, or any other change in the bond such that it no longer complies with the requirements of the rule.

FINRA Rule 4360 requires each member to maintain, at a minimum, fidelity bond coverage for any person associated with the member, except directors or trustees of a member who are not performing acts within the scope of the usual duties of an officer or employee. As further detailed below, the rule change eliminated the exemption in NASD Rule 3020 for sole stockholders and sole proprietors. The rule change also increased the minimum required fidelity bond coverage for members, while continuing to base the coverage on a member's net capital requirement. To that end, FINRA Rule 4360 required a member with a net capital requirement that is less than \$250,000 to maintain minimum coverage of the greater of 120 percent of the firm's required net capital under Exchange Act Rule 15c3-1 or \$100,000. The increase to \$100,000 modifies the present minimum requirement of \$25,000.

Under the new FINRA Rule 4360, members with a net capital requirement of at least \$250,000 must use a table in the rule to determine their minimum fidelity bond coverage requirement. The table is a modified version of the tables in NASD Rule 3020(a)(3) and NYSE Rule 319(e)(i). The identical NASD and NYSE requirements for members that have a minimum net capital requirement that exceeds \$1 million are retained in the new Rule; however, the rule adopts the higher requirements in NYSE Rule 319(e)(i) for a member with a net capital requirement of at least \$250,000, but less than \$1 million. Under the new rule, the entire amount of a member's minimum required coverage must be available for covered losses and may not be eroded by the costs an insurer may incur if it chooses to defend a claim. Specifically, any defense costs for covered losses must be in addition to a member's minimum coverage requirements. A

member may include defense costs as part of its fidelity bond coverage, but only to the extent that it does not reduce a member's minimum required coverage under the rule.

Under prior NASD Rule 3020(b), a deductible provision may be included in a member's bond of up to \$5,000 or 10% of the member's minimum insurance requirement, whichever is greater. If a member desires to maintain coverage in excess of the minimum insurance requirement, then a deductible provision may be included in the bond of up to \$5,000 or 10% of the amount of blanket coverage provided in the bond purchased, whichever is greater. The excess of any such deductible amount over the maximum permissible deductible amount based on the member's minimum required coverage must be deducted from the member's net worth in the calculation of the member's net capital for purposes of Exchange Act Rule 15c3-1. Where the member is a subsidiary of another member, the excess may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.<sup>7</sup> FINRA Rule 4360 provides for an allowable deductible amount of up to 25% of the fidelity bond coverage purchased by a member. Any deductible amount elected by the firm that is greater than 10% of the coverage purchased by the member<sup>8</sup> would be deducted from the

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<sup>7</sup> Under NYSE Rule 319(b), each member organization may self-insure to the extent of \$10,000 or 10% of its minimum insurance requirement as fixed by the NYSE, whichever is greater, for each type of coverage required by the rule. Self-insurance in amounts exceeding the above maximum may be permitted by the NYSE provided the member or member organization certifies to the satisfaction of the NYSE that it is unable to obtain greater bonding coverage, and agrees to reduce its self-insurance so as to comply with the above stated limits as soon as possible, and appropriate charges to capital are made pursuant to Exchange Act Rule 15c3-1. This provision also contains identical language to the NASD rule regarding net worth deductions for subsidiaries.

<sup>8</sup> FINRA notes that a member may elect, subject to availability, a deductible of less than 10 percent of the coverage purchased.

member's net worth in the calculation of its net capital for purposes of Exchange Act Rule 15c3-1.<sup>9</sup> Like the NASD and NYSE rules, if the member is a subsidiary of another FINRA member, this amount may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

Consistent with NASD Rule 3020(c) and NYSE Rule 319.10, FINRA Rule 4360 requires a member (including a firm that signs a multi-year insurance policy), annually as of the yearly anniversary date of the issuance of the fidelity bond, to review the adequacy of its fidelity bond coverage and make any required adjustments to its coverage, as set forth in the rule. Under FINRA Rule 4360(d), a member's highest net capital requirement during the preceding 12-month period, based on the applicable method of computing net capital (dollar minimum, aggregate indebtedness or alternative standard), is used as the basis for determining the member's minimum required fidelity bond coverage for the succeeding 12-month period. The "preceding 12-month period" includes the 12-month period that ends 60 days before the yearly anniversary date of a member's fidelity bond. This would give a firm time to determine its required fidelity bond coverage by the anniversary date of the bond.

Further, FINRA Rule 4360 allows a member that has only been in business for one year and elected the aggregate indebtedness ratio for calculating its net capital requirement to use, solely for the purpose of determining the adequacy of its fidelity bond coverage for its second year, the 15 to 1 ratio of aggregate indebtedness to net capital in

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<sup>9</sup> NASD Rule 3020 bases the deduction from net worth for an excess deductible on a firm's minimum required coverage, while FINRA Rule 4360 would base such deduction from net worth on coverage *purchased* by the member.

lieu of the 8 to 1 ratio (required for broker-dealers in their first year of business) to calculate its net capital requirement. Notwithstanding the above, such member would not be permitted to carry less minimum fidelity bond coverage in its second year than it carried in its first year.

Based in part on NASD Rule 3020(a), FINRA Rule 4360 exempts from the fidelity bond requirements members in good standing with a national securities exchange that maintain a fidelity bond subject to the requirements of such exchange that are equal to or greater than the requirements set forth in Rule 4360. Additionally, consistent with NYSE Rule Interpretation 319/01, FINRA Rule 4360 continues to exempt from the fidelity bond requirements any firm that acts solely as a Designated Market Maker ("DMM"),<sup>10</sup> floor broker or registered floor trader and does not conduct business with the public. FINRA Rule 4360 does not maintain the exemption in NASD Rule 3020(e) for a one-person firm.<sup>11</sup> Historically, a sole proprietor or sole stockholder member was excluded from the fidelity bond requirements based upon the assumption that such firms were one-person shops and, therefore, could not obtain coverage for their own acts. FINRA has determined that sole proprietors and sole stockholder firms can and often do acquire fidelity bond coverage, even though it is currently not required, since all claims

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<sup>10</sup> See Exchange Act Release No. 58845 (Oct. 24, 2008), 73 FR 64379 (Oct. 29, 2008) (Order Approving File No. SR-NYSE-2008-46). In this rule filing, the role of the specialist was altered in certain respects and the term "specialist" was replaced with the term "Designated Market Maker."

<sup>11</sup> A one-person member (that is, a firm owned by a sole proprietor or stockholder that has no other associated persons, registered or unregistered) has no "employees" for purposes of NASD Rule 3020, and therefore such a firm currently is not subject to the fidelity bonding requirements. Conversely, a firm owned by a sole proprietor or stockholder that has other associated persons has "employees" for purposes of NASD Rule 3020, and currently is, and will continue to be, subject to the fidelity bonding requirements.

(irrespective of firm size) are likely to be paid or denied on a facts-and-circumstances basis. Also, certain coverage areas of the fidelity bond benefit a one-person shop (*e.g.*, those covering customer property lost in transit).

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>12</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>13</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest, by updating and clarifying the requirements governing fidelity bonds. The Exchange believes that the proposed requirements of Rule 4360, including, but not limited to, requiring each member that is required to join SIPC to maintain blanket fidelity bond coverage, increasing the minimum requirement fidelity bond coverage and maintaining a fidelity bond that provides for per loss coverage without an aggregate limit of liability promotes investor protection by protecting firms from unforeseen losses. The proposed amendments will conform NASDAQ Rule 3020 to recent changes made to a corresponding FINRA rule, to promote application of consistent regulatory standards.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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<sup>12</sup> 15 U.S.C. 78f(b).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate, it has become effective pursuant to 19(b)(3)(A) of the Act<sup>14</sup> and Rule 19b-4(f)(6)<sup>15</sup> thereunder.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

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<sup>14</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>15</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2012-021 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2012-021. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit



personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-NASDAQ-2012-021 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>16</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>16</sup> 17 CFR 200.30-3(a)(12).

**Exhibit 5**

*Brackets indicate deletions; underlining indicates new text*

**NASDAQ Stock Market Rules****Equity Rules**

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**3020. Fidelity Bonds**

**(a)** Each member required to join the Securities Investor Protection Corporation who has employees and who is a member in good standing of another self-regulatory organization shall follow the applicable fidelity bond rule of the self-regulatory organization to which it is designated by the Commission for financial responsibility pursuant to Section 17 of the Act and SEC Rule 17d-1 thereunder.

**(b)** A member designated to Nasdaq for oversight pursuant to SEC Rule 17d-1 shall comply with [NASD]FINRA Rule 4360[3020] as if such Rule were part of Nasdaq's Rules. Nasdaq and FINRA are parties to the Regulatory Contract pursuant to which FINRA has agreed to perform certain functions on behalf of Nasdaq. Therefore, Nasdaq members are complying with Nasdaq Rule 3020 by complying with [NASD]FINRA Rule 4360[3020] as written, including, for example, filing requirements and notifications. In addition, functions performed by FINRA, FINRA departments, and FINRA staff under Nasdaq Rule 3020 are being performed by FINRA on behalf of Nasdaq.

**(c)** For purposes of this Rule:

**(1)** references to an "Association member" shall be construed as references to a "Nasdaq member", and

**(2)** references to Article I, paragraph (q) of the By-Laws shall be construed as references to Nasdaq Rule 1011,

**(d)** Pursuant to the Rule 9600 Series, any member subject to paragraph (c) of [NASD]FINRA Rule 4360[3020], through the application of Nasdaq Rule 3020(b), may apply to Nasdaq for an exemption from such requirements. The exemption may be granted upon a showing of good cause, including a substantial change in the circumstances or nature of the member's business that results in a lower net capital requirement. Nasdaq may issue an exemption subject to any condition or limitation upon a member's bonding coverage that is deemed necessary to protect the public and serve the purposes of this Rule.

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