Attachment B

<u>Illustrations of the Application of the Proposed Amendments as if adopted</u>

For purposes of these illustrations:

> The "<u>Exempt Account Exception</u>" refers to the exception pursuant to Rule 4210(f)(3)(B)(i), which applies to when-issued transactions in a cash account of a non-member broker-dealer or an exempt account; and
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> The "<u>DVP Account Exception</u>" refers to the exception pursuant to Rule 4210(f)(3)(B)(iii), which applies to when-issued transactions in the cash account of a bona fide DVP customer and settlement of the transaction occurs promptly after the securities are made available for delivery and no later than the 35th calendar day after the trade date.

Part I – When Issued Transactions.

A. <u>Equity IPO</u>. On T, a customer purchases common shares in an initial public offering (IPO) for settlement when, as, and if the shares are issued. The shares are to be issued on T+7.

   If the customer's purchase is effected in a cash account (including a DVP account), then pursuant to Rule 4210(f)(3)(B)(ii)a. no margin need be required, and no capital charge need be taken for mark to market losses so long as the IPO is a bona fide initial public offering to the general public for cash.

   If the customer's purchase is effected in a margin account, then, pursuant to Rule 4210(f)(3)(A)(i)a., the margin to be maintained on the customer's purchase is the same as if the shares were issued.

B. <u>Equity Follow-On Offering</u>. On T, a customer purchases common shares in a public offering for settlement when, as, and if the shares are issued. The shares are to be issued on T+7. This is a follow-on offering; the common shares were the subject of an IPO some time before the offering in which the customer purchased the shares.

   The Rule 4210(f)(3)(B)(ii)a. exception is not available because the offering is not an initial public offering.

   If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[1]

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[1] Capital charges in lieu of margin under Rule 4210(f)(3) are limited by the firm's capital. Pursuant to Rule 4210 (e)(2)(I), if the aggregate amount of capital charges for uncollected mark to market loss under Rule 4210(e)(2)(F) and (G) and uncollected margin under Rule 4210(f)(3) exceed

If the Exempt Account Exception is not available, but the DVP Account Exception is available, the firm may elect not to collect margin from the customer provided that the firm takes a capital charge for the amount of the otherwise required margin.[2]

If the customer's purchase is effected in a cash account and neither the Exempt Account Exception nor the DVP Account Exception is available, then, pursuant to Rule 4210(f)(3)(B)(i)d., the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account (or good faith account), then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the shares were issued.

C. Equity Follow-On Offering – Capital Charge Illustration. A firm is the underwriter in a registered follow-on offering of $10 million of exchange-listed equity common shares. The registration statement was effective after the close of business on T-1 and the shares are to be issued on T+7. On T, the firm confirmed the sale of $7 million of shares in cash accounts of exempt account customers (or non-member broker-dealers), $2 million of shares to non-exempt bona fide DVP customers (that are not broker-dealers), and $1 million of shares to regular (non-exempt, non-DVP customers that are not broker-dealers). The firm makes margin calls for all margin it is required to collect (and does not make margin calls for any margin it is not required to collect). The firm is subject to the following capital charges in connection with this distribution:

   a. Open Contractual Commitment Charges: Assuming that the firm's underwriting commitment was conditioned on the effectiveness of the registration statement, the firm was subject to an open contractual commitment charge under Rule 15c3-1(c)(2)(viii) when the registration statement became effective on T-1. For a follow-on offering of equity securities, the charge is 15% of the $10 million commitment, or $1.5 million, reduced by the firm's unrealized profit and any applicable amount of the $150,000 add-back. Once the firm confirmed sales of its entire commitment on T, the open contractual commitment charge was no longer required.

   b. Customers Qualifying for the Exempt Account Exception. The firm sold $7 million of shares in the cash accounts of exempt account customers or non-member broker-dealers. Under Rule 4210(f)(3)(B)(i), the firm is not required to

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for five business days either 5% of the firm's tentative net capital with respect to a single account or group of commonly controlled accounts or 25% of the firm's tentative net capital across all accounts, the firm must give notice to FINRA and may not enter into new transactions subject to paragraphs (e)(2)(F), (e)(2)(G), or (f)(3) that would result in an increase in the excess above the 5% or 25% thresholds.

2 Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

collect margin from these customers and is only required to take a capital charge if and when the customers incur a mark to market loss. If the market value of the shares declines below the offering price, creating a mark to market loss (and no margin is called or collected from these customers[3]), the firm is required to take a capital charge for the amount of the mark to market loss on the day it occurs and each subsequent day until it is eliminated or the purchase is settled.[4]

c. Non-Exempt Customers that qualify for the DVP Account Exception. The firm sold $2 million of shares to bona fide DVP customers that were not exempt accounts (or non-member broker-dealers). Under Rule 4210(f)(3)(B)(iii), the firm is not required to collect margin from these customers, but is required to take a capital charge for the amount of otherwise required margin. If it were not for this exception, Rule 4210(f)(3)(A)(i)a. and d. would require the firm to collect the margin that would be required if the shares were issued and purchased in a margin account. Under Rule 4210(c)(1), the margin on listed shares to be maintained in margin accounts is 25% of their current market value, or $500,000. Since the firm did not make any margin calls on these customers,[5] this capital charge is required as of T and each subsequent day until the customers pay for the shares. If the market value of the shares declines below the offering price, creating a mark to market loss (and no margin is called or collected from these customers), the firm is also required to take a capital charge for the amount of the mark to market loss as of the day it occurs and each subsequent day until it is eliminated or the purchase is settled.[6]

d. All Other Customers. The firm sold $1 million of shares to customers that were not exempt accounts, non-member broker-dealers, or bona fide DVP customers. Whether the sales were effected in the customers' cash or margin accounts, the firm is required by Rule 4210(f)(3)(A)(i)a. and d. to collect the margin that would be required if the shares were issued and purchased in a margin account. Under Rule 4210(c)(1), the margin on listed shares to be maintained in margin accounts is 25% of their current market value, or $250,000 in aggregate. The firm is

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[3] To the extent the firm calls for margin from these customers, it may give credit in the computation of capital charges to margin calls outstanding five business days or less. For the margin calls to delay or reduce capital charges, they must be bona fide – the firm must have a margining arrangement with the customer and expect that the customer generally will promptly satisfy margin calls.

[4] Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

[5] This is an assumption in the example because firms generally do not collect margin from DVP customers.

[6] Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

required to take a capital charge for any margin deficit, but it is permitted to give credit for margin calls outstanding five business days or less. Because it made margin calls for all required margin,[7] the firm will not incur any capital charges with respect to these accounts until T+5 at the earliest, and then only to the extent there are unmet margin calls.

D. Equity Rights Offering. On T, a customer exercises rights to purchase preferred shares in a registered rights offering. The preferred shares to be issued on T+7. No preferred shares of this class had been sold prior to the sales under the rights that were distributed to the holders of the issuer's common shares.

Although the preferred shares are equity securities and the sale under the rights offering is their initial public sale, the exception pursuant to Rule 4210(f)(3)(B)(ii)a. is not available because the shares are not being sold to the general public, but only to the rights holders (and the rights were distributed only to the holders of issuer's common shares).

If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[8]

If the Exempt Account Exception is not available but the DVP Account Exception is available, the firm may elect not to collect margin from the customer provided that the firm takes a capital charge for the amount of the otherwise required margin.[9]

If the customer's purchase is effected in a cash account and neither the Exempt Account Exception nor the DVP Account Exception is available, then, pursuant to Rule 4210(f)(3)(A)(i)d., the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account, then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the shares were issued.

E. Equity Exchange Offering. On T, a customer elects to participate in an exchange offer to exchange a corporate issuer's bonds for preferred shares in the issuer. The preferred

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7 This is an assumption in the example. If the firm were to fail to make a bona fide margin call on any of these customers, capital charges would be incurred as of the day of the customer's purchase and each subsequent day the margin requirement remains unmet.

8 Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

9 Capital charges in lieu of margin are limited by the firm's capital. *See* 1 above.

shares are to be issued on T+7. No preferred shares of that class had been sold prior to the exchange offering.

Although the preferred shares are equity securities and the sale in the exchange offering is their initial public sale, the exception pursuant to Rule 4210(f)(3)(B)(ii)a. is not available because the shares are not being sold to the general public and they are not sold for cash.

If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[10]

If the Exempt Account Exception is not available but the DVP Account Exception is available, the firm may elect not to collect margin from the customer provided that the firm takes a capital charge for the amount of the otherwise required margin.[11]

If the customer's purchase is effected in a cash account and neither the Exempt Account Exception nor the DVP Account Exception is available, then, pursuant to Rule 4210(f)(3)(A)(i)d, the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account, then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the shares were issued.

F. Debt IPO. On T, the firm sells a corporate bond to a customer in a public offering, for settlement when, as, and if the bonds are issued. The bonds are to be issued on T+7.

The exception pursuant to Rule 4210(f)(3)B)(ii)a. is not available because the bond is not an equity security.

If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[12]

If the Exempt Account Exception is not available but the DVP Account Exception is available, the firm may elect not to collect margin from the customer provided that the firm takes a capital charge for the amount of the otherwise required margin.[13]

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10 Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

11 Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

12 Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

13 Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

If the customer's purchase is effected in a cash account and neither the Exempt Account Exception nor the DVP Account Exception is available, then, pursuant to Rule 4210(f)(3)(A)(i)d., the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account (or good faith account[14]), then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the bond were issued.

G. <u>U.S. Treasury Securities, Scheduled Issuance within 14 Calendar Days of Trade Date</u>. On T, a customer purchases U.S. Treasury securities for settlement, when, as, and if issued. The scheduled issuance date ("dated date") is T+7.

If the customer's purchase is effected in a cash account (including a DVP account), then pursuant to Rule 4210(f)(3)(B)(ii)b. no margin need be required, and no capital charge need be taken for mark to market losses because the scheduled issuance date of T+7 is not later than the 14th calendar day after T.[15]

If the customer's purchase is effected in a margin account (or good faith account), then, pursuant to Rule 4210(f)(3)(A)(i)a., the margin to be maintained on the customer's purchase is the same as if the U.S. Treasury securities were issued.

H. <u>U.S. Treasury Securities, Scheduled Issuance Not within 14 Calendar Days of Trade Date</u>. On T, a customer purchases U.S. Treasury securities for settlement, when, as, and if issued. The scheduled issuance date ("dated date") is T+18.

The exception pursuant to Rule 4210(f)(3)(B)(ii)b. is not available because the scheduled issuance date of T+18 is later than the 14th calendar day after T.

If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[16]

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14 Supplementary Material .06 makes clear that "A Regulation T good faith account is treated as a margin account for purposes of Rule 4210."

15 The availability of this exception depends on the length of the period between the trade date of the customer's purchase and the scheduled issuance date of the U.S. Treasury securities. If, for example, sales of the U.S. Treasury securities open on May 31 and the scheduled issuance date is June 15 (*i.e.*, 15 calendar days after May 31), then the exception does not apply to customers who purchase on May 31. The exception does apply, however, to customers who purchase the bonds on June 3, since June 15 is the 12th day after June 3.

16 Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

If the Exempt Account Exception is not available but the DVP Account Exception is available, the firm may elect not to collect margin from the customer provided that the firm takes a capital charge for the amount of the otherwise required margin.[17]

If the customer's purchase is effected in a cash account and neither the Exempt Account Exception nor the DVP Account Exception is available, then, pursuant to Rule 4210(f)(3)(A)(i)d., the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account (or good faith account), then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the U.S. Treasury securities were issued.

I. Municipal Securities, Dated Date within 42 Calendar Days of Trade Date. On T, a customer purchases municipal bonds for settlement, when, as, and if issued. The scheduled issuance date ("dated date") is T+7.

Because the customer purchased municipal bonds, if the customer's purchase is effected in a cash account (including a DVP account), then pursuant to Rule 4210(f)(3)(B)(ii)c. no margin need be required, and no capital charge need be taken for mark to market losses because the scheduled issuance date of T+7 is not later than the 42nd calendar day after T.[18]

If the customer's purchase is effected in a margin account (or good faith account), then, pursuant to Rule 4210(f)(3)(A)(i)a., the margin to be maintained on the customer's purchase is the same as if the bonds were issued.

J. Municipal Securities, Dated Date Not within 42 Calendar Days of Trade Date. On T, a customer purchases municipal bonds for settlement, when, as, and if issued. The scheduled issuance date ("dated date") is T+50.

The exception pursuant to Rule 4210(f)(3)(B)(ii)c. is not available because the scheduled issuance date of T+50 is later than the 42nd calendar day after T.

The DVP Account Exception is not available because the scheduled issuance date of the bonds is more than 35 calendar days after the trade date.

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[17] Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

[18] The availability of this exception depends on the length of the period between the trade date of the customer's purchase and the scheduled issuance date of the municipal bonds. If, for example, sales of the municipal bonds open on May 31 and the scheduled issuance date is July 13 (*i.e.*, the 43rd calendar days after May 31), then the exception does not apply to customers who purchase on May 31. The exception does apply, however, to customers who purchase the bonds on June 3, since July 13 is the 40th calendar day after June 3.

If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[19]

If the customer's purchase is effected in a cash account and the Exempt Account Exception is not available, then, pursuant to Rule 4210(f)(3)(A)(i)d., the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account (or good faith account),[20] then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the bond were issued.

Part II — Other Extended Settlement Transactions

K. U.S. Treasury Securities Sold for T+4 Payment. On T, a firm sells an issued U.S. Treasury security in a transaction where the buyer is not required to pay until T+4. This is an extended settlement transaction.

L. Cash Account Purchase with T+4 Settlement Date. On T, a firm sells a security to a customer in a transaction with a stated settlement date of T+4. This transaction is generally an extended settlement transaction; however, it would not be an extended settlement transaction if the firm documents and accepts in good faith the purchaser's agreement to deposit full cash payment for the security with the firm by T+2.

M. Regular Way Sale to DVP Account. On T, the firm sells a security to a bona fide DVP customer. Under the firm's agreement with the DVP customer, the customer is required to pay when the firm delivers the security. At the time of the transaction, the firm expected that the transaction would be settled on T+2 in the ordinary course of business. Unexpected delays due to the mechanics of the transaction, however, cause a delay in delivery until T+7, at which time the customer makes full cash payment.

   This transaction is not an extended settlement transaction. The customer agreed to make full cash payment upon an occurrence of an event (the delivery of the security) that the firm expects would occur on T+2 in the ordinary course of business.

   This transaction should have a stated settlement of T+2 since that is the date the firm expects to settle.

N. Sale to DVP Account with Expected Delays. On T, the firm sells a security to a bona fide DVP customer. Under the firm's agreement with the DVP customer, the customer is

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[19] Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

[20] Supplementary Material .06 makes clear that "A Regulation T good faith account is treated as a margin account for purposes of Rule 4210."

required to pay when the firm delivers the security. At the time of the transaction, the firm does not expect the security to be available for delivery until after T+2.

This is an extended settlement transaction because the customer has not agreed to pay by T+2, but rather upon the occurrence of an event that the firm does not expect to occur until after T+2.[21] However, if the expected delay is due to the mechanics of the transaction (not the customer's willingness or ability to pay) and does not extend beyond 35 calendar days from the trade date, then pursuant to Rule 4210(f)(3)(C)(iii), the firm may take a capital charge in lieu of collecting margin from the bona fide DVP customer.[22]

O. <u>Extended Settlement Transaction with Broker-Dealer</u>. On T, the firm sells an issued security to another registered broker-dealer in a transaction where the buyer is not required to pay until T+6. This is an extended settlement transaction subject to Rule 4210, unless the other broker-dealer is an exempted borrower under Regulation T. If the other broker-dealer is not an exempted borrower, then pursuant to Rule 4210(e)(6)(A), the transaction may be maintained on a margin basis satisfactory to the firm and the other broker-dealer, provided that the firm adheres to Regulation T, does not carry the other broker-dealer's account in a deficit equity condition, and takes the capital charges required by Rule 4210(e)(6)(A).

P. <u>Customer Purchase with Expected Delays</u>. On T, the firm sells a security to a customer that the firm does not expect to have available for delivery until T+7. The firm agrees with the customer that payment will be due upon delivery, but the firm and the customer do not have a payment on delivery (POD)/collect on delivery (COD) arrangement that satisfies the requirements of FINRA Rule 11860.

This is an extended settlement transaction. Although the delays in settlement are due to the mechanics of the transaction, the firm cannot avail itself of Rule 4210(f)(3)(C)(iii) to take a capital charge in lieu of collecting margin because the customer is not a bona fide DVP customer.

Q. <u>Long Sale with Expected Delays.</u> On T, a customer sells in the customer's cash account a security that the customer owns (and has paid for in full), but does not expect to be able to deposit with the firm by T+2. This is an extended settlement transaction.

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21 Although booking or confirming the transaction with a stated settlement date after T+2 is indicative of the firm's expectation that the transaction would not settle until after T+2, booking or confirming the transaction as T+2 would not prevent the transaction from being an extended settlement transaction when the firm does not expect settlement to occur on T+2.

22 Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.