

Notices

Regulatory Notices

- 10-27** Changes to Customer Complaint Reporting Procedures Under NASD Rule 3070(c) and NYSE Rule 351(d); **Effective Date: July 1, 2010**
- 10-28** New System for Processing Regulation T and SEA Rule 15c3-3 Extension of Time Requests; **Effective Dates: August 23, 2010 (Phase I); November 8, 2010 (Phase II)**
- 10-29** SEC Approves Amendments to Rules on Reporting Transactions to the OTC Reporting Facility; **Effective Date: November 1, 2010**
- 10-30** SEC Approves Amendments Permitting FINRA to Halt Trading by Firms Otherwise Than on an Exchange Where a Primary Listing Market Has Issued a Trading Pause Due to Extraordinary Market Volatility; **Effective Date: June 10, 2010**
- 10-31** Change to Expedited Proceedings for Failure to Comply with an Arbitration Award or Related Settlement; **Effective Date: July 2, 2010**

Information Notice

- 06/15/10** May 2010 Supplement to the Options Disclosure Document

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Customer Complaint Reporting

Changes to Customer Complaint Reporting Procedures Under NASD Rule 3070(c) and NYSE Rule 351(d)

Effective Date: July 1, 2010

Executive Summary

Starting on July 1, 2010, the beginning of the third calendar quarter, firms must use revised and new product codes to report statistical information regarding written customer complaints relating to annuities and life settlement products. The first report using the revised and new codes is due by October 15, 2010, which is the reporting deadline for customer complaints received during the third calendar quarter.

Questions concerning this *Notice* should be directed to Anthony Cavallaro, Central Review Group, at (646) 315-7319.

Background & Discussion

NASD Rule 3070(c) and Incorporated NYSE Rule 351(d) require all member firms to report on quarterly basis statistical information regarding written customer complaints.¹ Firms must report this information by the 15th calendar day of the month following the end of each calendar quarter (*e.g.*, by April 15 for the first quarter). The statistics that firms report provide FINRA with important regulatory information that assists with the timely identification of potential sales practice and operational issues. FINRA is revising the product code relating to annuities and adding new product codes to better categorize the customer complaint information.

New Product Codes & Descriptions

Based on a review of the underlying products reported under current Product Code 20 (Annuities), FINRA is redefining that code and adding two additional codes. Revised Product Code 20 will refer only to variable

June 2010

Notice Type

- Guidance

Suggested Routing

- Legal and Compliance
- Operations
- Senior Management

Key Topics

- Customer Complaint Reporting
- Problem and Product Code Changes

Referenced Rules & Notices

- NASD Rule 3070(c)
- NYSE Rule 351(d)
- NYSE Rule 351.13

annuities, whereas new Product Codes 43 and 44 will relate to fixed and equity indexed annuities, respectively. In addition, FINRA has added Product Code 45 to capture customer complaints relating to life settlement products.

The revised and new product codes are as follows:

► **Product Code 20 (Variable Annuities)**

A variable annuity is an insurance company contract that allows the owner to elect to receive immediate or future periodic payments. A variable annuity is purchased, either with a lump sum or over time, with premiums allocated among various, separate account funds offered in the annuity contract. During the accumulation phase, the rate of return and the contract fund value on a variable annuity fluctuates with the performance of the underlying investments in the separate account funds, sometimes called investment portfolios or subaccounts.

► **Product Code 43 (Fixed Annuities)**

A fixed annuity is an insurance contract that is purchased either in a lump sum or over time. A fixed annuity is credited with a fixed or set interest rate and allows the owner to elect to receive immediate or future periodic payments. The insurance company guarantees both earnings and principal.

► **Product Code 44 (Equity-Indexed Annuities)**

An equity-indexed annuity is an insurance company product purchased either in a lump sum or with a series of payments. The insurance company credits the holder with a return that is based on performance of an equity index, such as the S&P 500 Composite Stock Price Index. The insurance company may guarantee a minimum return. After the accumulation period, the insurance company makes periodic payments under the terms of the contract or in a lump sum.

► **Product Code 45 (Life Settlements)**

A life settlement is a financial transaction in which a policy owner sells an existing life insurance policy to a third party for more than the policy's cash surrender value, but less than the net death benefit.

Endnote

- 1 FINRA has incorporated into its rulebook certain rules of the NYSE, including NYSE Rule 351. The Incorporated NYSE rules apply solely to those members of FINRA that are also members of NYSE (Dual Members).

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Extension of Time Requests

New System for Processing Regulation T and SEA Rule 15c3-3 Extension of Time Requests

Effective Dates: August 23, 2010 (Phase I); November 8, 2010 (Phase II)

Executive Summary

Beginning August 23, 2010, FINRA will introduce, in phases, a new Regulatory Extension (REX) system that replaces FINRA's existing Reg T system to collect Regulation T and SEA Rule 15c3-3 extension of time requests. The new REX system offers enhanced functionality that will:

- give firms the ability to amend or update submitted extension requests;
- offer firms a wider variety of search fields for reviewing their submitted extension requests;
- introduce text fields that firms can use to input their own, internal identifiers for each extension request; and
- offer firms that submit extension requests via batch submission a daily report of submissions.

Also effective August 23, 2010, clearing firms must submit their monthly reporting of correspondent firms' extensions to transaction ratio by completing an online form accessible via the FINRA Firm Gateway through the new REX system. FINRA has revised the layout of the form, but it is otherwise unchanged.

June 2010

Notice Type

- Guidance

Suggested Routing

- Compliance
- Institutional
- Legal
- Operations
- Registered Representatives
- Senior Management
- Systems

Key Topic(s)

- Extension Processing

Referenced Rules & Notices

- NASD Rule 3160
- NTM 06-62
- Regulatory Notice 08-32
- Regulation T §§ 220.4 and 220.8
- SEA Rule 15c3-3

This *Notice* also details new and modified data elements for the REX system.

Questions concerning this *Notice* should be directed to:

- Rudolph Verra, Managing Director, Risk Oversight and Operational Regulation, at (646) 315-8811;
- Glen Garofalo, Director, Credit Regulation, at (646) 315-8464; or
- Vincent Rotolo, Senior Credit Specialist, Credit Regulation, at (646) 315-8576.

Background & Discussion

Regulation T, issued by the Federal Reserve Board pursuant to the Securities Exchange Act of 1934 (SEA), governs, among other things, the extension of credit by broker-dealers to customers to pay for the purchase of securities.¹ SEA Rule 15c3-3, among other things, requires broker-dealers to promptly obtain and maintain physical possession or control of customer securities, and designates periods of time within which broker-dealers must satisfy any deficiency (including those that arise from a customer “long” sale for which the customer has not delivered the securities within the requisite time period) by buying-in or otherwise obtaining possession or control of the securities.²

Under SEA Rule 15c3-3(n), a self-regulatory organization (SRO) may extend certain specified periods to buy-in a security, for one or more limited periods commensurate with the circumstances, where the SRO: (1) is satisfied that the broker-dealer is acting in good faith in making the request; and (2) exceptional circumstances warrant such action.³ Regulation T has a similar standard to allow an extension of time for payment for the purchase of securities.⁴

NASD Rule 3160 requires all clearing firms for which FINRA is the designated examining authority (DEA) to submit extension of time requests under Regulation T or SEA Rule 15c3-3(n) to FINRA. Since the SRO designated as a firm’s DEA has responsibility for examining its firms’ compliance with applicable financial responsibility rules such as Regulation T and SEA Rule 15c3-3, requiring a firm to submit extension requests to its DEA helps to ensure that the DEA receives complete extension information to assist it in performing this regulatory function. As further detailed below, each clearing firm for which FINRA is the DEA also must file a monthly report with FINRA indicating all broker-dealers for which it clears that exceed a given ratio of requested extensions of time to total transactions.

Personnel preparing extension of time requests are expected to obtain supporting documentation authorizing or requesting them to apply for an extension of time on behalf of a customer. Firms are reminded that a customer is not entitled to an extension of time. As noted above, firms may only request extensions of time in exceptional circumstances, and they are responsible for determining the appropriateness of requesting any such extension.

New REX System

The new REX system will permit FINRA to process, monitor and service firms' extension of time requests more accurately and efficiently. It will also enhance FINRA's surveillance and examination capabilities. Historically, firms have requested extensions of time through FINRA's Reg T system via the FINRA Firm Gateway and Regulation Filing Applications system. Effective August 23, 2010, the new REX system will replace the Reg T system. As with the legacy Reg T system, firms will be able to request extensions of time through the new REX system via the FINRA Firm Gateway by completing an online request form, or by transmitting a file via a batch-processing feed using FTP or SFTP. However, firms will no longer have the ability to upload files directly on the REX system interface, as was permitted with the Reg T system.

Following are the implementation dates for the new REX System:

Submission Method for Extension of Time Requests	Date Firm Must Use New REX Online Format for Extension of Time Requests
Online Request Form	August 23, 2010
Batch File*	No Later Than November 8, 2010**

* Firms that file through the batch process will be required to use a new directory for batch submissions beginning August 23, 2010 (the location of the "drop off" and "pick up" directory will be changing). See the "Testing" section below for details.

** Firms that transmit extension of time requests by batch file may begin using the new REX batch file format on August 23, 2010, but may continue to submit extension of time requests using the current Reg T batch file format until November 8, 2010.

Firms that use a service bureau to submit extension of time requests on their behalf must ensure that the information in this *Notice* is promptly communicated to their service bureaus so that any programming changes are effective by August 23, 2010. Please note that new user access is not required for the REX system: all user IDs and passwords will automatically transfer from the Reg T system to the new REX system. See the “Testing” section below for details regarding submission procedures.

The new REX system, which is XML-based,⁵ will allow firms to amend and re-submit extension requests that, for example, do not initially meet the rule requirements upon submission. Firms can review extension request status immediately using the online Web interface and on the firm’s daily extension report that will be delivered on the business day following submission (see the “Reports” section below). It is the firm’s responsibility to review these reports on a daily basis. FINRA expects firms to submit all changes to extension requests by the business day following initial submission. Clearing firms will have the capability to correct extension requests both online and through the batch submission process. All firm-initiated corrections will require final approval from FINRA’s Credit Regulation Department. It will be the firm’s responsibility to follow up on amended extension requests and take any necessary action if the extension request does not get approved.

Expanded File Format/Layout and Data Elements

As noted above, the REX system contains new and modified data elements that firms must implement depending on their submission method. Firms that submit extension of time requests via the online request form must use the new REX online format effective August 23, 2010. Accordingly, such firms must implement the new and modified data elements by August 23, 2010. Firms that transmit extension of time requests by batch file have the option to begin using the new REX batch file format on August 23, 2010; if they elect to do so, they must implement the new and modified data elements at that time (firms may continue to submit extension of time requests using legacy Reg T batch file format until November 8, 2010). The system will assign default values for the new and modified data elements when the legacy Reg T batch file format is used as specified in the table below. On November 8, 2010, firms must submit all batch file extension of time requests via the new REX batch format, and the new and modified data elements will be required from all batch submitters.

The table below lists and describes the new and modified data elements. FINRA reminds firms to review *Regulatory Notice 08-32* (June 2008), which discusses in detail the current data elements’ requirements.

DATA ELEMENT	OPTIONAL/REQUIRED	NOTES	DEFAULT VALUE FOR LEGACY FORMAT BATCH FILE SUBMISSIONS ⁶
Product Code	Required	<p>This data field captures the type of product traded for which an extension is being requested (<i>e.g.</i>, the type of product identified by the <i>Issue Symbol/CUSIP</i> field value). Firms must select one of the following values:</p> <ul style="list-style-type: none"> • Equity • Option • Derivative • Mutual fund • Bond <p>In the case of <i>multiple trades</i>, firms must choose one product code, Issue Symbol/CUSIP and share amount, and enter the aggregate value of all of the trades in the submission for that account.</p>	Equity
Correspondent Firm Type	Required	<p>Firms must indicate if they are submitting the extension on behalf of a correspondent firm. This element is a modification of the <i>Correspondent Firm Flag</i> data element in the legacy Reg T system. Firms must select one of the following values:</p> <ul style="list-style-type: none"> • Domestic <ul style="list-style-type: none"> ➤ If this value is selected, the Correspondent Firm CRD Number, the Correspondent Branch CRD Number, Customer Contact CRD Type and Customer Contact CRD ID fields must be completed. 	<p>Legacy "Y" → <i>Domestic</i></p> <p>Any other value → <i>None</i></p>

DATA ELEMENT	OPTIONAL/ REQUIRED	NOTES	DEFAULT VALUE FOR LEGACY FORMAT BATCH FILE SUBMISSIONS ⁶
		<ul style="list-style-type: none"> • Foreign <ul style="list-style-type: none"> ➤ If this value is selected, the name of the foreign correspondent broker-dealer must be submitted in the new Foreign IB Name data field below. • None <ul style="list-style-type: none"> ➤ If this value is selected, the Branch CRD Number of the clearing firm must be completed.⁷ 	
Foreign IB Name	Required	<p>Foreign correspondent firm name must be provided if the extension is being requested on behalf of a foreign correspondent firm and the <i>Correspondent Firm Type</i> indicator has been set to <i>Foreign</i>.</p> <p><i>***Note: It is important to be consistent when submitting names in this field. For example, please do not use "Acme, Inc." in one extension request, and "Acme, Incorporated" in another extension request for the same firm.</i></p>	Field will be blank
Customer Contact CRD Type	Required	<p>This field indicates the CRD number of the Registered Representative assigned to the account, if any. Firms must select one of the following values:</p> <ul style="list-style-type: none"> • RegisteredRep <ul style="list-style-type: none"> ➤ If this value is selected, the customer contact CRD ID field must contain the Registered Representative CRD number. 	RegisteredRep.

DATA ELEMENT	OPTIONAL/ REQUIRED	NOTES	DEFAULT VALUE FOR LEGACY FORMAT BATCH FILE SUBMISSIONS ⁶
		<ul style="list-style-type: none"> ● SelfDirected <ul style="list-style-type: none"> ➤ This option is reserved explicitly for online accounts and hedge funds that are self directed and do not have a Registered Representative assigned to the account. <p><i>***Note: If the extension of time request relates to paragraph (d)(2),(d)(3) or (h) of SEA Rule 15c3-3, this field is not required. This field is also not required when the Correspondent Firm Type is Foreign.</i></p>	
Contra ID Code for (d)(2) extensions	Required	<p>This field is a modification of the <i>Contra Broker Dealer CRD Number</i> field from the legacy Reg T system. This field indicates the type of identification from the broker-dealer failing to deliver the securities. Firms must select one of the following values:</p> <ul style="list-style-type: none"> ● CRD <ul style="list-style-type: none"> ➤ If this value is selected, the <i>Contra ID</i> field must contain the CRD number of the contra firm. ● DTCC <ul style="list-style-type: none"> ➤ If this value is selected, the <i>Contra ID</i> field must contain the DTCC number of the contra firm. 	DTCC

DATA ELEMENT	OPTIONAL/REQUIRED	NOTES	DEFAULT VALUE FOR LEGACY FORMAT BATCH FILE SUBMISSIONS ⁶
Original Request Date	Required	This field was previously named "Request Date" and is renamed to clarify the meaning of the data value. The <i>Original Request Date</i> does not change for subsequent requests on the same extension.	Existing required field so no default value is necessary
Submitter's Job Reference ID	Optional	This field allows the submitting firm to include its own identifier for a batch submission for firm internal tracking purposes. It is being maintained and available for searching by FINRA systems.	Field will be blank
Request Action	Required	<p>This field will indicate if the current extension request is an <i>Amendment</i> or <i>New</i> extension request. Note that if the value <i>Amendment</i> is selected, it means the submitter is correcting an error in a previously submitted extension request.</p> <p>Creating a "follow-on" (or "subsequent extension," "second extension," "third extension," etc.) for an expired extension request is <i>not</i> an Amendment. It is considered a <i>New</i> extension request (albeit a new extension request that is requesting additional time for the expired request).</p> <p><i>***Note that Amendments for an extension request are expected to be submitted within one business day following the submission of the original extension request.</i></p>	New

DATA ELEMENT	OPTIONAL/ REQUIRED	NOTES	DEFAULT VALUE FOR LEGACY FORMAT BATCH FILE SUBMISSIONS ⁶
Submitter Comment	Required for Amendments	Submitters must include in this field a detailed explanation of the reason for the amendment.	Field will be blank
Received By	Required	This field indicates the pathway by which the extension request was entered into the REX system. Firms must select one of the following values: <ul style="list-style-type: none"> • Batch V1 (Legacy Reg T batch file format) • Batch V2 (new REX batch file format) • UI (online request form). 	BatchV1
Withdrawn Flag	Required	This field should be set to <i>Yes</i> when a firm is withdrawing a previously submitted extension request. A withdrawal is considered an amendment, and therefore the submitter must complete the <i>Submitter Comment</i> field as to why the extension request is being withdrawn. This field should be set to <i>No</i> unless the intent is to withdraw the extension request.	No
Submitter's Filing Reference ID	Optional	This field allows the submitting firm to include its own identifier for a particular extension request for firm internal tracking purposes. This field will be maintained and available for searching by FINRA systems.	Field will be blank

DATA ELEMENT	OPTIONAL/REQUIRED	NOTES	DEFAULT VALUE FOR LEGACY FORMAT BATCH FILE SUBMISSIONS ⁶
FINRA Filing ID	Future use	This field will be blank at the time of initial release and will be programmed at a later date. FINRA will issue a subsequent <i>Regulatory Notice</i> with details about the requirements and timing.	Field will be blank
FINRA Filing Version	Future Use	This field will be blank at the time of initial release and will be programmed at a later date. FINRA will issue a subsequent <i>Regulatory Notice</i> with details about the requirements and timing.	Field will be blank

Additional information about the new file format is available at www.finra.org/rex/technicalinformation, including a mapping of legacy batch file data elements to the new XML-based batch file data elements, and the technical XSD, which provides a standards-based definition for the new batch XML file format. To accommodate the new batch XML file format, firms will need to make significant changes to their automated processes that generate batch files that adhere to the legacy Reg T file format in order to submit extension of time requests using the new file format. See the “Testing” section below for details about submission procedures.

Monthly Reporting Requirement—Correspondent Firm Extensions

NASD Rule 3160(b) requires each clearing firm for which FINRA is the DEA to file a monthly report with FINRA indicating all broker-dealers for which it clears (*i.e.*, correspondent firms) that have overall ratios of extension of time requests to total transactions for the month that exceed a percentage specified by FINRA (the current extension-to-transaction ratio is 2 percent).⁸ Clearing firms must continue to submit the monthly report by completing an online form via the FINRA Firm Gateway; however, with the introduction of the REX system, firms will need to use a revised form beginning August 23, 2010. A sample of the form is available at www.finra.org/rex/sampleextensionform. The same information and reporting time periods and thresholds are required as detailed in *Notice to Members 06-62*, though the REX application will pre-populate the correspondent broker-dealer's CRD number(s) and the number of extension requests submitted (based on the Regulation T and SEA Rule 15c3-3 extension requests received during the previous month). Firms will be able to override the pre-populated information as necessary.

Reports

Firms will have access, via the new REX system, to functionality that will allow users to search for specific extensions or groups of extensions, based on a wide variety of search criteria, including *Disposition Status (Granted, Denied, Pending)*. From the search results, users will be able to view all of the data for any submitted extension of time request.

Effective August 23, 2010, if a firm elects to use the new REX batch file format, the firm will receive two results reports via FTP or SFTP (depending on how the batch file was submitted). One of the results reports is a flat text file that is formatted similarly to the batch report file used in the legacy Reg T system. This flat file format for the results report will not be available after November 8, 2010.

The other results report is an XML-formatted file that contains all of the information regarding all extension of time requests the firm submitted, including extension requests submitted via the online request form. This file will be delivered to batch submitters on a nightly basis, and will also contain information regarding "finalized"⁹ customers. The details regarding the format for this XML file can be reviewed at www.finra.org/rex/technicalinformation. This results report will be available beginning August 23, 2010. This results report will also be available online upon request for firms that submit extension requests via the online request form.

The *Disposition Status (Granted, Denied, Pending)* of submitted extensions can be viewed on the daily report. Firms need to review this report on a daily basis and all necessary change requests are expected to be submitted by the following business day.

Testing

Because the new REX system will require firms to make modifications to their systems, FINRA has created a REX Customer Test Environment (CTE) for the online request form, which is available now for testing at <https://gateway1.firms.qc.finra.org>.

For firms that will transmit batch files via FTP or SFTP, FINRA will now accept test data files transmitted through its testing environment. Firms should send files via FTP or SFTP to their current Reg T FTP or SFTP test server, **but dropped off in the RPT_REGT2/in** subdirectory. The results reports will be posted to the same server, in the firm's **RPT_REGT2/out** subdirectory. **Please Note:** *to test batch submissions in the new REX system, regardless of which file format is used, firms must drop off files in the RPT_REGT2/in subdirectory.*

Firms must use the same subdirectory names in the production environment once the REX system goes live on August 23, 2010. Users should be able to use their existing FINRA CTE user ID and password for the testing. Firms that encounter technical problems, or need to request a FINRA user ID and password, should contact the FINRA Help Desk at (800) 321-6273. FINRA encourages firms to begin testing as soon as possible to ensure a smooth transition to the REX system.

File Format Layout

The REX and Reg T file format layouts are available at www.finra.org/rex/technical information.

Additional Support

For additional support with the changes addressed in this *Notice*, see the REX tutorial at www.finra.org/Industry/Tools.

Endnotes

- 1 12 CFR 220.4(c) and 220.8(d). Regulation T provides that a customer has one payment period (currently five business days) to submit payment for purchases of securities in a cash account or in a margin account.
- 2 17 CFR 240.15c3-3.
- 3 See SEA Rule 15c3-3(n), authorizing SROs to extend the periods of time to buy-in a security specified in SEA Rules 15c3-3(d)(2), (d)(3), (h) and (m).
- 4 Under Regulation T, a firm's examining authority may grant an extension unless the examining authority believes that the broker-dealer is not acting in good faith or that the broker-dealer has not sufficiently determined that exceptional circumstances warrant such action. See Regulation T §§ 220.4(c) and 220.8(d).
- 5 XML (extensible mark up language) is a commonly used file formatting standard that is easily validated, human-readable, and readily digested by computer systems.
- 6 Since these data elements do not exist in the legacy Reg T batch file format, the application will provide a default value for these data elements for all extension requests submitted between August 23 and November 8, 2010, using the legacy Reg T batch file format.
- 7 See *Regulatory Notice 08-32* for further discussion of the Branch CRD Number data element.
- 8 See *NTM 06-62*. Self-clearing firms that do not clear for other firms are not required to file these reports because such firms do not have any correspondent broker extension information to provide to FINRA.
- 9 The term "finalized" refers to individual customers who have reached their allowable limit of extensions; *i.e.*, the customer has received five Regulation T extensions or nine SEA Rule 15c3-3 extensions in the preceding 12 months.

Trade Reporting

SEC Approves Amendments to Rules on Reporting Transactions to the OTC Reporting Facility

Effective Date: November 1, 2010

Executive Summary

Effective Monday, November 1, 2010, firms must comply with amended rules on applicable trade report modifiers when reporting OTC transactions in non-NMS stocks to the OTC Reporting Facility.

The text of the amendments can be found at www.finra.org/rulefilings/2009-061.

Questions regarding this *Notice* may be directed to:

- The Legal Section, Market Regulation, at (240) 386-5126; or
- The Office of General Counsel at (202) 728-8071.

Background and Discussion

The SEC recently approved amendments to FINRA Rule 6622(a) (When and How Transactions are Reported) relating to the reporting of over-the-counter (OTC) transactions in non-NMS stocks¹ to the OTC Reporting Facility (ORF).²

The amendments reorganize the format and structure of FINRA Rule 6622(a) so that it conforms generally to the trade reporting rules of the Alternative Display Facility (ADF) and Trade Reporting Facilities (TRFs).³ Rule 6622(a) identifies the types of transactions (*e.g.*, Stop Stock) that must have a unique trade report modifier associated with them; the specific modifiers are labeled in the ORF technical specifications and not in the rule.⁴ Firms must use such modifiers on all trade reports submitted to the ORF, including reports of “as/of” trades. In the event that the rules require multiple modifiers on any given trade report, firms must report in accordance with guidance FINRA has published regarding priorities among modifiers.⁵

June 2010

Type of Notice

- Rule Amendment

Suggested Routing

- Compliance
- Executive Representatives
- Legal
- Operations
- Senior Management
- Systems
- Trading
- Training

Key Topics

- Direct Participation Program Securities
- Non-NMS Stocks
- OTC Equity Securities
- OTC Reporting Facility
- Restricted Equity Securities
- Stop Stock Transactions
- Trade Reporting

Referenced Rules & Notices

- FINRA Rule 6420
- FINRA Rule 6622

Additionally, the amendments require that firms now use:

- ▶ modifiers that denote Seller's Option, Cash and Next Day settlement options;
- ▶ a modifier for trade pricing based on an average weighting or another special pricing formula; and
- ▶ a modifier for Stop Stock transactions, as defined in FINRA Rule 6420 (firms currently are required to report such transactions with the ".W" modifier).⁶

Although not required under current FINRA Rule 6622(a), firms can use the above-referenced modifiers when reporting to the ORF today.

Endnotes

- 1 Reportable transactions in non-NMS stocks include, for example, OTC equity securities (such as OTC Bulletin Board and Pink Sheets securities), direct participation program securities (*See Regulatory Notice 10-24*) and restricted equity securities sold pursuant to Securities Act Rule 144A (*See Regulatory Notice 10-26*).
- 2 *See* Securities Exchange Act Release No. 61819 (March 31, 2010), 75 FR 17806 (April 7, 2010) (Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of File No. SR-FINRA-2009-061).
- 3 *See generally* FINRA Rules 6282(a), 6380A(a) and 6380B(a).
- 4 *See* www.nasdaqtrader.com/content/technicalsupport/specifications/TradingProducts/ctci_act.pdf and www.nasdaqtrader.com/content/technicalsupport/specifications/TradingProducts/fixactspec.pdf.
- 5 *See, e.g.*, Section 401, Trade Reporting Frequently Asked Questions, available at www.finra.org/tradereportingfaq.
- 6 Stop Stock transactions will be disseminated to the public with the weighted average price modifier, which is consistent with the current dissemination policy for Stop Stock transactions that are submitted to the ADF and TRFs.

Trading-Pause Pilot Program

SEC Approves Amendments Permitting FINRA to Halt Trading by Firms Otherwise Than on an Exchange Where a Primary Listing Market Has Issued a Trading Pause Due to Extraordinary Market Volatility

Effective Date: June 10, 2010

Executive Summary

On June 10, 2010, FINRA began a pilot program in which it will halt trading otherwise than on an exchange with respect to securities included in the S&P 500® Index where the primary listing market has issued a trading pause due to extraordinary market volatility. The pilot is set to end on December 10, 2010.

Frequently asked questions about the trading-pause pilot are in Attachment A of this *Notice*. The text of the amendments to FINRA Rule 6121 can be found in the online FINRA Manual at www.finra.org/finramanual.

Questions regarding this *Notice* should be directed to:

- FINRA Operations at (866) 776-0800; or
- Racquel Russell, Assistant General Counsel, Office of General Counsel, at (202) 728-8363.

Background and Discussion

On June 10, 2010, the Securities and Exchange Commission (SEC) approved an amendment to FINRA Rule 6121 to permit FINRA to halt trading in individual securities where the primary listing market has issued a trading pause in that security due to a move of 10 percent or more from a sale in a preceding five-minute period (the trading-pause rule).¹ This rule change was a part of a coordinated effort among FINRA, the SEC and other self-regulatory organizations to provide for a coordinated means to address potentially destabilizing market volatility, such as the type of sudden price declines that were experienced on the afternoon of May 6, 2010.

June 2010

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management
- Systems
- Trading and Market Making

Key Topics

- Extraordinary Market Volatility
- Quotations
- Trading Halts

Referenced Rules & Notices

- NTM 02-82
- FINRA Rule 6121
- FINRA Rule 5260

As set forth in the similar, recently approved rule changes filed by several national securities exchanges, the primary listing markets will issue trading pauses for individual securities if the price of such security moves 10 percent or more from a sale in a preceding five-minute period.² The primary listing markets will notify FINRA, the other exchanges and market participants of the imposition of a trading pause by immediately disseminating a special indicator over the consolidated tape.

New Supplementary Material .01 to FINRA Rule 6121 provides that FINRA will similarly pause trading otherwise than on an exchange by FINRA member firms when the primary listing market has issued a trading pause.³ Thus, whenever the primary listing market issues an individual security trading pause under its rules, trading otherwise than on an exchange in that security also will be halted until trading has resumed on the primary listing market.⁴

Firms must have policies and procedures in place that are reasonably designed to ensure that, among other things, they promptly cease effecting transactions during a halt, as required by FINRA Rule 5260.

FINRA is implementing the trading-pause rule on a pilot basis. The pilot period will enable the SEC, FINRA and the exchanges to assess the effect of the new rules on the marketplace. Initially, the rule is in effect only for securities included in the S&P 500 Index, but FINRA anticipates that these rules will be expanded in the near future to additional securities, such as ETFs, within the pilot period.

Endnotes

- 1 See Securities Exchange Act Release No. 62251 (June 10, 2010) (Order Approving SR-FINRA-2010-025).
- 2 See Securities Exchange Act Release No. 62252 (June 10, 2010) (Order Approving File Nos. SR-BATS-2010-014; SR-EDGA-2010-01; SR-EDGX-2010-01; SR-BX-2010-037; SR-ISE-2010-48; SR-NYSE-2010-39; SR-NYSEAmex-2010-46; SR-NYSEArca-2010-41; SR-NASDAQ-2010-061; SR-CHX-2010-10; SR-NSX-2010-05; SR-CBOE-2010-047).
- 3 The exchanges' trading-pause rules apply from 9:45 a.m., ET until 3:35 p.m., ET on days when the exchanges are open during regular trading hours.
- 4 See Question #6, in Attachment A, for a discussion of the sole circumstance under which trading otherwise than on an exchange will be permitted to resume prior to the resumption of trading on the primary listing market.

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Attachment A: Frequently Asked Questions

Question 1: When will the trading-pause pilot begin and how long will it last?

FINRA's trading pause rule became effective on June 10, 2010, and currently is set to end on December 10, 2010.

Question 2: When can trading pauses occur during the trading day?

A trading pause can be triggered between 9:45 a.m., Eastern Time (ET) and 3:35 p.m., ET. No trading pause in an individual security will be called outside of these times. While a trading pause will not be implemented after 3:35 p.m., ET, a trading pause can remain in effect as late as 3:45 p.m., ET.

Question 3: What securities will be included in the pilot?

Consistent with the national securities exchanges, the trading pause pilot includes all S&P 500 Index stocks and may be expanded to include additional securities during the course of the pilot.

Question 4: Can all market center prints, including transactions executed otherwise than on an exchange, trigger a trading pause, or just the primary listing market?

All regular way, in-sequence prints, including transactions executed otherwise than on an exchange, sent to the Consolidated Tape or NASDAQ UTP SIP that are "last sale" eligible can trigger a trading pause. For more information regarding what types of trades are "last sale" eligible, consult the relevant plan's technical specification document at www.utpplan.com and www.nyxdata.com/CTA.

Question 5: During a trading pause, can a security trade otherwise than on an exchange?

No. Upon the receipt of notice from the primary listing market that the market has issued a trading pause in an individual security, trading otherwise than on an exchange in that security also is halted.

Question 6: When can trading in a paused security resume?

Consistent with the operation of trading halts in exchange-listed securities today, when trading has resumed on the primary listing market at the end of the five-minute pause, trading otherwise than on an exchange also may resume immediately in that security.

If a primary listing market extends the trading pause beyond the initial five-minute pause and reopens the security at or before the end of ten minutes, trading otherwise than on an exchange likewise may resume immediately at that time.

In the unusual circumstance where the primary listing market does not reopen for trading at the end of the ten-minute pause, FINRA may permit the resumption of trading otherwise than on an exchange in such security. FINRA expects that in most cases, it will not resume trading until the primary listing market resumes trading. However, if the primary listing market has issued notice that it cannot resume trading for a reason other than a significant imbalance and trading has commenced on at least one other national securities exchange, FINRA may determine to permit the resumption of trading otherwise than on an exchange. In such cases, FINRA will notify firms via its website at www.finra.org/traderesumption if it determines that trading otherwise than on an exchange may resume. If no such notice is provided, then trading otherwise than on an exchange may not resume until the primary listing market has resumed trading.

Question 7: If a member firm routes an order for execution on behalf of a customer prior to the primary listing market issuing a trading pause in that security, but the halt takes effect before the member firm has filled the customer order, can the member firm fill the customer order during the halt with the execution received prior to the halt?

No. As stated in *Notice to Members (NTM) 02-82*, a member firm cannot execute any part of an order once a trading halt is in effect. Therefore, member firms may not, for example, complete the second leg of a riskless principal transaction or otherwise fill a customer order with shares received in an execution prior to a halt taking effect until the halt has been lifted.

Question 8: If an issue that is listed on a foreign market is subject to a trading halt on a U.S. market, but not halted on the foreign market, may a firm trade the security on the foreign market consistent with FINRA Rule 5260?

No. As stated in *NTM 02-82*, member firms may not directly effect trades on international markets for their own accounts and may not solicit customer orders in these securities. If a member firm receives an unsolicited customer order in a security subject to a trading halt, it may route the order to a non-member entity or non-member affiliate not covered by the halt for execution in a foreign market.

Expedited Proceedings

Change to Expedited Proceedings for Failure to Comply with an Arbitration Award or Related Settlement

Effective Date: July 2, 2010

Executive Summary

Firms and associated persons will be unable to rely on an inability-to-pay defense in expedited actions¹ for failure to comply with arbitration awards involving customers if the FINRA Rule 9554 notice initiating the action is sent on or after July 2, 2010.²

The text of amended FINRA Rule 9554 is set forth in Attachment A.

Questions regarding this *Notice* should be directed to James S. Wrona, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8270.

Background & Discussion

FINRA Rule 9554 allows FINRA to bring expedited actions to address failures to comply with FINRA arbitration awards and related settlements. Once a monetary award has been issued in a FINRA arbitration proceeding, the party has 30 days to pay the award.³ FINRA coordinates with its dispute resolution and enforcement programs by verifying whether a firm or associated person (the respondent) has paid a monetary award on time. If the respondent has not paid, FINRA ordinarily initiates an expedited proceeding by sending a notice explaining that the respondent will be suspended unless the respondent pays the award or requests a hearing.

June 2010

Notice Type

- Guidance

Suggested Routing

- Compliance
- Legal
- Senior Management

Key Topics

- Arbitration Awards
- Expedited Proceedings
- Inability to Pay

Referenced Rules & Notices

- FINRA Rule 9554
- FINRA Rule 10330(h)

A respondent that requests a hearing may raise a number of defenses to the suspension. One of those defenses previously had been establishing a bona fide inability to pay.⁴ When a respondent successfully demonstrated an inability to pay, that was a complete defense to the suspension.

FINRA's expedited proceedings under Rule 9554 use the leverage of a potential suspension to help ensure that a firm or an associated person promptly pays a valid arbitration award. However, if a respondent demonstrated a financial inability to pay the award—regardless of the reason—the leverage was removed. When FINRA's efforts to suspend a respondent who had not paid an award were defeated, a claimant was much less likely to be paid.

Consequently, FINRA proposed, and the SEC recently approved, an amendment to FINRA Rule 9554 that explicitly eliminates the inability-to-pay defense in the expedited-proceedings context when a respondent fails to comply with an arbitration award or related settlement involving a customer. The amendment becomes effective on July 2, 2010. A bona fide inability to pay will not be a valid defense in an expedited action for failure to pay an arbitration award or related settlement involving a customer if the notice issued pursuant to FINRA Rule 9554 is sent on or after July 2, 2010.

However, a respondent still will have the following four defenses available:

- The firm or person paid the award in full or fully complied with the settlement agreement;
- The arbitration claimant has agreed to installment payments or has otherwise settled the matter;
- The firm or person has filed a timely motion to vacate or modify the arbitration award and such motion has not been denied; and
- The firm or person has filed a petition in bankruptcy and the bankruptcy proceeding is pending, or the bankruptcy court has discharged the award or payment owed under the settlement agreement.⁵

Endnotes

- 1 Expedited actions allow FINRA to address certain types of misconduct more quickly than would be possible using the ordinary disciplinary process. In general, these actions focus on encouraging respondents to comply with the law or take corrective action rather than on sanctioning them for past misconduct.
- 2 See Exchange Act Release No. 62211 (June 2, 2010), 75 FR 32525 (June 8, 2010) (SR-FINRA-2010-014) (Order Approving Proposed Rule Change Relating to FINRA Rule 9554 to Eliminate Explicitly the Inability-to-Pay Defense in the Expedited Proceedings Context). The approved amendment does not affect the defenses available in actions that do not involve customers.
- 3 FINRA Rule 10330(h).
- 4 The inability-to-pay defense emerged from a series of Securities and Exchange Commission decisions that require FINRA to consider the defense in *disciplinary* cases (as opposed to expedited actions), including disciplinary cases involving failures to pay arbitration awards and restitution. See Exchange Act Release No. 62211 (June 2, 2010), 75 FR 32525, 32526 (June 8, 2010) (citing *Toney L. Reed*, 52 S.E.C. 944 (1996), *recons. denied*, Exchange Act Release No. 39354 (Nov. 25, 1997); *Bruce M. Zipper*, 51 S.E.C. 928 (1993)).
- 5 Bankruptcy judges are experts in evaluating whether a debtor's obligations should be legally discharged. The bankruptcy process and associated filings are designed to consider fully and evaluate the financial condition of bankruptcy debtors. See 4 COLLIER ON BANKRUPTCY, 521.01, 521.09 (15th ed. 2009). In addition, bankruptcy filings, which are subject to federal perjury charges, provide greater penalties for hiding assets. See 18 U.S.C. §§ 151-58 (2010) (stating that bankruptcy fraud is punishable by a fine, or by up to five years in prison, or both).

ATTACHMENT A

(New language is underlined.)

* * * * *

9554. Failure to Comply with an Arbitration Award or Related Settlement or an Order of Restitution or Settlement Providing for Restitution**(a) Notice of Suspension or Cancellation**

If a member, person associated with a member or person subject to FINRA's jurisdiction fails to comply with an arbitration award or a settlement agreement related to an arbitration or mediation under Article VI, Section 3 of the FINRA By-Laws or a FINRA order of restitution or FINRA settlement agreement providing for restitution, FINRA staff may provide written notice to such member or person stating that the failure to comply within 21 days of service of the notice will result in a suspension or cancellation of membership or a suspension from associating with any member. When a member or associated person fails to comply with an arbitration award or a settlement agreement related to an arbitration or mediation under Article VI, Section 3 of the FINRA By-Laws involving a customer, a claim of inability to pay is no defense.

(b) through (h) No Change.

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Information Notice

May 2010 Supplement to the Options Disclosure Document

On May 24, 2010, the SEC approved a supplement to the Options Disclosure Document (ODD) (www.optionsclearing.com/components/docs/May_2010_ODD_Definitive_Supplement.pdf). The ODD contains general disclosures on the characteristics and risks of trading standardized options. The recently approved supplement adds new disclosure regarding the characteristics of options on conventional index-linked securities,¹ as well as the special risks of these options. In addition, the ODD is amended to add BATS Exchange, Inc. and its corporate address to the front inside cover page of the ODD. As with other supplements to the ODD, this should be read in conjunction with the current ODD, Characteristics and Risks of Standardized Options (www.optionsclearing.com/components/docs/riskstoc.pdf).

Rule 9b-1 under the Securities Exchange Act requires broker-dealers to deliver the ODD and supplements to customers.² FINRA has similar requirements in FINRA Rule 2360(b)(11)(A)(1), which requires firms to deliver the current ODD to each customer at or before the time the customer is approved to trade options. In addition, FINRA Rule 2360(b)(11)(A)(1) requires firms to distribute a copy of each ODD supplement to customers who previously received the ODD. Firms must deliver the ODD supplements no later than the time a customer receives a confirmation of a transaction in the category of options to which the amendment pertains. Rule 2360(b)(11)(A)(3) requires FINRA to advise firms when revisions to the ODD are made.

June 15, 2010

Suggested Routing

- Compliance
- Institutional
- Legal
- Options
- Senior Management
- Trading

Key Topics

- Conventional Index-Linked Options
- Options
- Options Disclosure Document

Referenced Rules & Notices

- FINRA Rule 2360
- NTM 98-3
- SEA Rule 9b-1

To comply with the requirements of FINRA Rule 2360(b)(11)(A)(1), firms may distribute the ODD supplement in various ways, including, but not limited to, one of the following:

1. conducting a mass mailing of the supplement to all of its customers approved to trade options who have already received the ODD; or
2. distributing the supplement to a customer who has already received the ODD not later than the time a customer receives a confirmation of a transaction in the category of options to which the amendment pertains.

FINRA reminds firms that they may electronically transmit documents that they are required to furnish to customers under FINRA rules, including the ODD and supplements thereto, provided the firm adheres to the standards contained in the May 1996 and October 1995 Securities Exchange Commission Releases,³ and as discussed in *Notice to Members 98-3* (www.finra.org/notices/ntm/98-3). Firms may also transmit the ODD and supplements to customers who have consented to electronic delivery through the use of a hyperlink.

Questions regarding this *Notice* may be directed to Kathryn M. Moore, Assistant General Counsel, Office of General Counsel, at (202) 974-2974.

Endnotes

- 1 For purposes of the ODD, conventional index-linked securities refer to non-convertible debt of an issuer (with a term of at least one year, but not greater than 30 years) that provides for the payment at maturity of a cash amount based directly on the performance of a specified underlying "reference asset."
- 2 17 CFR 240.9b-1.
- 3 See Securities Act Release No. 7288 (May 9, 1996) 61 FR 24644 (May 15, 1996) and Securities Act Release No. 7233 (October 6, 1995) 60 FR 53458 (October 13, 1995).
- 4 See Securities Act Release No. 58738 (October 6, 2008) 73 FR 60371 (October 10, 2008).