

Notices

Regulatory Notices

- 10-45** SEC Approval and Effective Date for New Consolidated FINRA Rules Regarding Margin Requirements, Daily Record of Required Margin, and Extension of Time Requests; **Effective Date: December 2, 2010**
- 10-46** Supplemental FOCUS Filing Requirement Applicable to Certain Joint Broker-Dealers/Futures Commission Merchants; **Effective Date: FOCUS Report Due on November 23, 2010, Covering the October 2010 Reporting Period**
- 10-47** SEC Approves Consolidated FINRA Rule on the Sale of Securities in a Fixed Price Offering; **Effective Date: February 8, 2011**
- 10-48** Amendments to FINRA Trade Reporting and OATS Rules to Reinstitute Short Sale Exempt Marking and to Require Price and Short Exempt Identifier on Route Reports; **Effective Date: November 10, 2010**
- 10-49** SEC Approval and Effective Date for New Consolidated FINRA Rules; **Effective Date: December 15, 2010**
- 10-50** Securities Industry/Regulatory Council on Continuing Education Issues Firm Element Advisory Update
- 10-51** Sales Practice Obligations for Commodity Futures-Linked Securities
- 10-52** Application of Rules on Communications With the Public and Institutional Sales Material and Correspondence to Certain Free Writing Prospectuses
- 10-53** Margin Requirements for Exempted Securities Mutual Funds and Exempted Securities ETFs; **Effective Date: October 26, 2010**
- 10-54** FINRA Requests Comment on Concept Proposal to Require a Disclosure Statement for Retail Investors at or Before Commencing a Business Relationship; **Comment Period Expires: December 27, 2010**
- 10-55** FINRA Establishes a New Effective Date for Reporting Asset-Backed Securities to TRACE and Related Rule Changes; **Effective Date: May 16, 2011**
- 10-56** SEC Approves Amendments to the Trading Activity Fee and FINRA Announces Publication of Frequently Asked Questions; **Effective Date: November 1, 2010**

continued

Election Notice

10/21/10 Notice of SFAB Election and Ballots

Information Notices

10/15/10 Continuing Education Planning

10/08/10 Extension of Current Rate for Fees Paid Under Section 31 of the Exchange Act

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Margin and Extension of Time Requests

SEC Approval and Effective Date for New Consolidated FINRA Rules Regarding Margin Requirements, Daily Record of Required Margin, and Extension of Time Requests

Effective Date: December 2, 2010

Executive Summary

FINRA's rule change¹ to adopt consolidated rules regarding margin requirements, daily record of required margin and extension of time requests under Regulation T and SEA Rule 15c3-3 for the Consolidated FINRA Rulebook² becomes effective December 2, 2010.

The new FINRA rules are based on and replace provisions in the NASD and Incorporated NYSE Rules.³ The new rules also clarify that a firm must take into account the special deductions from net capital set forth in FINRA Rule 4210 (Margin Requirements) in determining its status under FINRA Rule 4120 (Regulatory Notification and Business Curtailment).⁴

This *Notice* also announces the adoption of the Incorporated NYSE Rule 431 Interpretations, subject to certain amendments, as interpretations to FINRA Rule 4210, which also become effective December 2, 2010.

The text of the new rules is in Attachment A on our website at www.finra.org/notices/10-45. The FINRA Rule 4210 interpretations are available at www.finra.org/rules/4210interpretations.

October 2010

Notice Type

- Consolidated Rulebook
- Rule Approval

Suggested Routing

- Compliance
- Institutional
- Legal
- Margin
- Operations
- Regulatory Reporting
- Senior Management
- Systems
- Trading

Key Topic(s)

- Extension of Time Requests
- Margin
- Regulation T
- SEA Rule 15c3-3

Referenced Rules & Notices

- FINRA Rule 2360
- FINRA Rule 2370
- FINRA Rule 4110
- FINRA Rule 4120
- FINRA Rule 4210
- FINRA Rule 4220
- FINRA Rule 4230
- SEA Rule 15c3-3

Questions concerning this *Notice* should be directed to:

- ▶ Rudolph R. Verra, Managing Director, Risk Oversight and Operational Regulation, at (646) 315-8811;
- ▶ Glen Garofalo, Director, Credit Regulation, at (646) 315-8464;
- ▶ Steve Yannolo, Principal Credit Specialist, Credit Regulation, at (646) 315-8621; or
- ▶ Kathryn Moore, Assistant General Counsel, Office of General Counsel, at (202) 974-2974.

Background and Discussion

A. FINRA Rule 4210 (Margin Requirements)

FINRA has adopted the requirements set forth in NASD Rule 2520 (Margin Requirements) and related NASD margin rules and interpretations (NASD Rules 2521, 2522 and IM-2522), subject to certain amendments discussed below, as new FINRA Rule 4210 (Margin Requirements).

The amendments, among other things, reflect certain requirements in Incorporated NYSE Rule 431 (Margin Requirements). FINRA Rule 4210, like its predecessor rules, prescribes requirements governing the extension of credit by firms that offer margin accounts to customers, as permitted in accordance with Regulation T of the Board of Governors of the Federal Reserve System (Regulation T).⁵ The rule promulgates the margin requirements that determine the amount of collateral customers are expected to maintain in their margin accounts, including strategy-based margin accounts and portfolio margin accounts. Maintenance margin requirements for equity, fixed income, warrants and option securities are also established under the rule.

Rule Structure

FINRA has restructured the consolidated rule to improve its organization and make it easier to read. FINRA Rule 4210(h) provides that any firm for which another self-regulatory organization acts as the designated examining authority is exempt from FINRA Rule 4210.

In addition, FINRA Rule 4210(f)(2)(A) contains streamlined definitions for margining options, currency warrants, currency index warrants and stock index warrant transactions. FINRA also combined the margin provisions regarding currency warrants, currency index warrants and stock index warrants from NASD Rule 2520(f)(10) together with similar sections in paragraph (f)(2) of FINRA Rule 4210.

Finally, the supplementary material to FINRA Rule 4210 provides illustrations on how to calculate the number of elapsed days for accrued interest on Treasury bonds or notes.

Net Capital Calculations

In certain instances, FINRA Rule 4210 specifies that firms should reference SEA Rule 15c3-1 and, if applicable, FINRA Rule 4110 (Capital Compliance), when computing net capital charges against net capital and haircut requirements.⁶ Firms may be subject to greater net capital requirements pursuant to the provisions of paragraph (c) of FINRA Rule 4110.

Joint Accounts Exemption

FINRA integrated Incorporated NYSE Rule 431 Supplementary Material .10 into FINRA Rule 4210(e)(3) regarding joint accounts in which the carrying firm or a partner or stockholder has an interest. The provision permits a firm to seek an exemption under the FINRA Rule 9600 Series if the account is confined exclusively to transactions and positions in exempted securities. FINRA Rule 4210(e)(3) provides the required information to be included in any such application.

Additional Requirements on Control and Restricted Securities and Relationship to FINRA Rule 4120

FINRA adopted provisions from Incorporated NYSE Rule 431 pertaining to deductions from net capital on control and restricted securities. These provisions, set forth in FINRA Rule 4210(e)(8)(C)(ii), (iii) and (v), require that a firm make deductions from its net capital if it extends credit over specified thresholds on control and restricted securities, and it must take such deductions into account when determining if it has reached any of the financial triggers specified in FINRA Rule 4120 (Regulatory Notification and Business Curtailment).⁷ The rule change also made conforming amendments to FINRA Rule 4120(a)(1)(F) and (c)(1)(F) to clarify that a firm must take into account the special deductions from net capital set forth in FINRA Rule 4210(e)(8)(C) in determining its status under FINRA Rule 4120.

Day Trading

FINRA integrated Supplementary Material .60 from Incorporated NYSE Rule 431 in FINRA Rule 4210(f)(8)(B)(iii) to provide that the day-trading buying power for non-equity securities may be computed using the applicable special maintenance margin requirements pursuant to other provisions of the margin rule. In addition, FINRA adopted Supplementary Material .30 from Incorporated NYSE Rule 431 as FINRA Rule 4210(f)(8)(B)(iv)b. to provide that in the event that the firm at which a customer seeks to open an account or resume day trading in an existing account knows or has a reasonable basis to believe that the customer will engage in pattern day trading, then the minimum equity requirement of \$25,000 must be deposited in the account prior to commencement of day trading.

Portfolio Margining

FINRA amended FINRA Rule 4210(g)(5)(B) to highlight that portfolio margin-eligible participants, in addition to being required to be approved to engage in uncovered short option contracts pursuant to FINRA Rule 2360 (Options), must be approved to engage in security futures transactions pursuant to FINRA Rule 2370 (Security Futures), if eligible participants engage in such transactions.

Conforming Amendments

FINRA added the terms “approved market maker,” “market maker” and “market making” to FINRA Rule 4210(f)(10)(F) to conform to rule changes made by the NYSE.⁸ The NYSE changes were made in connection with the operation of the NYSE’s Market Model.⁹ As a result of the implementation of these changes, the NYSE amended several of its rules, including NYSE Rule 431(f)(10)(F), to add the terms “approved market maker,” “market maker” and “market making” to reflect the current Designated Market Makers operating on the NYSE. FINRA amended the definitions of the same terms used in FINRA Rule 4210(e)(5)(A) and (f)(10)(E) for consistency purposes.

Clarifying and Technical Amendments

Finally, FINRA made several technical changes to the margin rule text to update terminology and similar clarifications. First, FINRA added definitions regarding “listed” and “OTC” options.

Second, in FINRA Rule 4210(f)(2)(l)(iv), FINRA made several clarifications to terminology where no margin may be required if the specified options or warrants are carried “short” in the account of a customer, against an escrow agreement, and either are held in the account at the time the options or warrants are written or received in the account promptly thereafter. The rule change clarified that with respect to such options or warrants, an escrow agreement is used, in a form satisfactory to FINRA, issued by a third-party custodian bank or trust company, and in compliance with the requirements of Rule 610 of The Options Clearing Corporation.

The rule change also replaced the term “guarantor” with the term “custodian” to more accurately reflect the third party’s role. In addition, the rule change revised the definition of what constitutes a qualified security by eliminating the reference to the list of Over-the-Counter Margin Stocks published by the Board of Governors of the Federal Reserve System as the Federal Reserve no longer publishes such a list.

Margin Interpretations

FINRA is also adopting Incorporated NYSE Rule 431 Interpretations, subject to certain amendments, as interpretations to FINRA Rule 4210. The FINRA Rule 4210 interpretations, which become effective on December 2, 2010, are available on our website at www.finra.org/rules/4210interpretations.

B. FINRA Rule 4220 (Daily Record of Required Margin)

FINRA adopted Incorporated NYSE Rule 432(a) (Daily Record of Required Margin) as FINRA Rule 4220 in substantially the same form. The rule sets forth the requirements for daily recordkeeping of initial and maintenance margin calls that are issued pursuant to Regulation T and the margin rules.

C. FINRA Rule 4230 (Required Submissions of Requests for Extension of Time Under Regulation T and SEA Rule 15c3-3)

FINRA adopted NASD Rule 3160 (Extensions of Time Under Regulation T and SEC Rule 15c3-3) as FINRA Rule 4230. FINRA added a provision to FINRA Rule 4230 to clarify that for the months when no broker-dealer for which a clearing firm clears exceeds the extension-of-time ratio criteria specified by FINRA (currently set at 2 percent), the clearing firm must submit a report indicating such.

As noted above, the new rules become effective December 2, 2010.

Endnotes

- 1 See Securities Exchange Act Release No. 62482 (July 12, 2010) 75 FR 41562 (July 16, 2010) (SEC Order Granting Approval to File No. SR-FINRA-2010-024).
- 2 The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA member firms, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The FINRA Rules apply to all FINRA firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see *Information Notice 3/12/08* (Rulebook Consolidation Process).
- 3 Effective December 2, 2010, NASD Rules 2520, 2521, 2522 and 3160; NASD IM-2522; Incorporated NYSE Rules 431, 432 and 434; and all Incorporated NYSE Rule 431 Interpretations will be deleted from the Transitional Rulebook.
- 4 FINRA notes that, in devoting this *Notice* to announcing the effective date of a single set of rules and rule amendments, it is deviating from the protocol by which FINRA generally announces the effective dates of the new FINRA rules that are being adopted as part of the consolidated rulebook. See *Information Notice 10/06/08* (Rulebook Consolidation Process: Effective Dates of New Consolidated Rules; Introduction of Rule Conversion Chart). FINRA believes that a single *Notice* devoted to the new margin and extension of time request rules is warranted in view of the regulatory subject matter.

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Endnotes continued

- 5 *See* Regulation T Section 220.4.
- 6 *See, e.g.*, FINRA Rule 4210(e)(2)(D), (e)(2)(F), (e)(2)(G), (e)(4), (e)(5) and (e)(6).
- 7 *See Regulatory Notice 09-71* (SEC Approves Consolidated FINRA Rules Governing Financial Responsibility) (December 2009) regarding FINRA Rule 4120.
- 8 *See* Securities Exchange Act Release No. 59077 (December 10, 2008) 73 FR 76691 (December 17, 2008) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change by New York Stock Exchange LLC Amending Exchange Rule 104T to Make a Technical Amendment to Delete Language Relating to Orders Received by NYSE Systems and DMM Yielding; Clarifying the Duration of the Provisions of Rule 104T; Making Technical Amendments to Rule 98 and Rule 123E to Update Rule References for DMM Net Capital Requirements; Rescinding Paragraph (g) of Rule 123; and Making Conforming Changes to Certain Exchange Rules to Replace the Term “Specialist” with “DMM”; File No. SR-NYSE-2008-127).
- 9 *See* Securities Exchange Act Release No. 58845 (October 24, 2008), 73 FR 64379 (October 29, 2008) (SEC Approval Order of SR-NYSE-2008-46 approving certain rules to operate as a pilot scheduled to end October 1, 2009.) *See also* Securities Exchange Act Release No. 60756 (October 1, 2009), 74 FR 51628 (October 7, 2009) (SR-NYSE-2009-100); Securities Exchange Act Release No. 61031 (November 19, 2009), 74 FR 62368 (November 27, 2009); and Securities Exchange Act Release No. 61724 (March 17, 2010), 75 FR 14221 (March 24, 2010) (extending the operation of the pilot until the earlier of SEC approval to make permanent or September 30, 2010). As part of this new model, the functions formerly carried out by specialists on the NYSE were replaced by a new market participant, known as a Designated Market Maker (DMM).

FOCUS Reporting

Supplemental FOCUS Filing Requirement Applicable to Certain Joint Broker-Dealers/Futures Commission Merchants

Effective Date: FOCUS Report Due on November 23, 2010, Covering the October 2010 Reporting Period

Executive Summary

Beginning with the monthly FOCUS Report that is due on November 23, 2010 (covering the October 2010 reporting period), each member firm that is a futures commission merchant (FCM) and clears OTC derivatives for customers through Chicago Mercantile Exchange Inc. (CME)—either as a CME clearing member itself or as a carrying, non-clearing firm through a CME clearing member—must file with FINRA a new statement pertaining to customer cleared OTC derivatives. This requirement arises from recent amendments by CME to its financial reporting rules and forms and by National Futures Association (NFA) to its financial requirements rules.

The new statement—the Statement of Sequestration Requirements and Funds in Cleared OTC Derivatives Sequestered Accounts (Sequestration Statement)—is a supplemental schedule to FOCUS Report Parts II and II CSE and firms must file it with FINRA as part of their monthly FOCUS Reports.

The Sequestration Statement is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- Yui Chan, Managing Director, Risk Oversight & Operational Regulation (ROOR), at (646) 315-8426; or
- Kathryn Mahoney, Director, ROOR, at (646) 315-8428.

October 2010

Notice Type

- Guidance

Suggested Routing

- Accounting
- Compliance
- Legal
- Operations
- Regulatory Reporting
- Senior Management

Key Topics

- FOCUS Reporting

Referenced Rules & Notices

- SEA Rule 17a-5
- FINRA Rule 4521

Background and Discussion

Effective May 6, 2010, the Commodity Futures Trading Commission (CFTC) adopted new amendments to the CFTC's Regulation Part 190¹ that, among other things, create a new customer account class for "cleared OTC derivatives" (as defined in new CFTC Regulation 190.01(o)), applicable only to the bankruptcy of a commodity broker that is an FCM.² As stated in the CFTC adopting release for these new regulations, "... a position in an OTC derivative (and relevant collateral) that a customer clears through an FCM with a DCO [derivatives clearing organization], which position (and collateral) is not subject to a Section 4d [of the Commodity Exchange Act] Order, would be considered part of the cleared OTC derivative account class, as soon as, but only after, a DCO rule... that requires such positions (and relevant collateral) to be held in a separate account for cleared OTC derivatives becomes effective..."³

Following the CFTC's adoption of the new Regulation Part 190 requirements, CME, as a DCO, adopted new rules requiring that customer "cleared OTC derivatives" be held in a separate account, titled "Customer Cleared OTC Derivatives Sequestered Account," subject to specified requirements, including the preparation of a Sequestration Statement.⁴ NFA also adopted rule amendments that would require its carrying, non-clearing FCM members that clear OTC derivatives for customers through a CME clearing member to comply with CME's new rules as well.⁵

In June, CME advised FCMs to develop the necessary accounting and operational systems, procedures and controls to ensure that they are able to adhere to the new requirements when the rules become effective.⁶ Among other things, CME stated that FCMs should open new bank and safekeeping accounts for cleared OTC customer assets. The new CME sequestration requirements became effective on October 4, 2010.⁷

Pursuant to FINRA Rule 4521(a), FINRA member firms that are FCMs and that clear OTC derivative products through a DCO or any other facility that has OTC derivatives sequestration requirements, in complying with such facility's requirements, must file with FINRA the Sequestration Statement, or such similar form as the facility may require, as a supplement to the electronic FOCUS Report filing (FOCUS Report Parts II and II CSE). FINRA member firms that are FCMs and subject to CME's requirements must file the Sequestration Statement in eFOCUS and WinJammer, commencing with the monthly FOCUS Report that is due November 23, 2010 (covering the October 2010 reporting period).

Endnotes

- 1 See 17 CFR Chapter 1 Part 190 (Bankruptcy).
- 2 See 75 FR 17297 (April 6, 2010).
- 3 See *supra* note 2 at 17301.
- 4 CME's new cleared OTC derivatives sequestration rules are set forth in CME Group Audit Information Bulletin #10-07 (issued July 16, 2010). For further information regarding the CME's implementation of the new rules, see also CME Group Audit Information Bulletin #10-09 (issued August 17, 2010) and CME Group Advisory Notice #10-256 (Updates #1 and #2) (issued June 17, 2010).
- 5 See Letter from Thomas W. Sexton, Senior Vice President and General Counsel, NFA, to David A. Stawick, Office of the Secretariat, CFTC, dated August 30, 2010. The new NFA rule—NFA Financial Requirements Section 4(b)—states that any NFA member FCM “that receives money, securities and/or other property from, for or on behalf of a customer to margin, guarantee or secure the customer's positions in cleared OTC derivatives... must comply with CFTC requirements and the requirements established by the applicable contract market and/or derivatives clearing organization for such activity.”
- 6 See CME Group Advisory Notice #10-256 (Update #1).
- 7 See CME Group Audit Information Bulletin #10-09.

Fixed Price Offerings

SEC Approves Consolidated FINRA Rule on the Sale of Securities in a Fixed Price Offering

Effective Date: February 8, 2011

Executive Summary

The SEC approved FINRA's proposed rule change¹ to adopt a new rule governing fixed price offerings for the consolidated FINRA rulebook (the Consolidated FINRA Rulebook).² The new rule—FINRA Rule 5141—protects the integrity of fixed price offerings by ensuring that securities in such offerings are sold to the public at the stated public offering price or prices. The new rule is based in part on, and replaces, provisions in the NASD Rules.³

The text of the new rule is set forth in Attachment A.

The rule change takes effect on February 8, 2011.

Questions concerning this *Notice* should be directed to:

- ▶ Adam H. Arkel, Assistant General Counsel, Office of General Counsel (OGC), at (202) 728-6961; or
- ▶ Gary L. Goldsholle, Vice President and Associate General Counsel, OGC, at (202) 728-8104.

Background & Discussion

FINRA Rule 5141 is a new, consolidated rule that protects the integrity of fixed price offerings⁴ by ensuring that securities in such offerings are sold to the public at the stated public offering price or prices. The rule prohibits the grant of certain preferences (*e.g.*, selling concessions, discounts, other allowances or various economic equivalents) in connection with fixed price offerings of securities.

October 2010

Notice Type

- ▶ Consolidated FINRA Rulebook
- ▶ New Rule

Suggested Routing

- ▶ Corporate Financing
- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Senior Management

Key Topics

- ▶ Fixed Price Offerings

Referenced Rules & Notices

- ▶ NASD Rule 0120
- ▶ NASD Rule 2730
- ▶ NASD Rule 2740
- ▶ NASD Rule 2750
- ▶ NASD IM-2730
- ▶ NASD IM-2740
- ▶ NASD IM-2750
- ▶ FINRA Rule 5130
- ▶ FINRA Rule 5141

General Requirements; Definition of “Reduced Price”

FINRA Rule 5141(a) provides that no member or person associated with a member that participates in a selling syndicate or selling group⁵ in connection with a fixed price offering may offer or grant, directly or indirectly, to any person⁶ or account that is not a member of the selling syndicate or selling group any securities in the offering at a price below the stated public offering price (*i.e.*, a “reduced price”).⁷ The term “reduced price” is defined under FINRA Rule 5141.01 to include, without limitation, any offer or grant of any selling concession, discount or other allowance, credit, rebate, reduction of any fee (including any advisory or service fee), any sale of products or services at prices below reasonable commercially available rates for similar products and services (except for research, which, as discussed below, is subject to FINRA Rule 5141.02), or any purchase of or arrangement to purchase securities from the person or account at more than their fair market price in exchange for securities in the offering.⁸

The requirements of the new rule apply until the termination of the offering or until a member, having made a bona fide public offering of the securities, is unable to continue selling such securities at the stated public offering price. For purposes of the rule, securities in a fixed price offering are presumed salable if the securities immediately trade in the secondary market at a price or prices which are above the stated public offering price.

Sales to Affiliated Persons

FINRA Rule 5141(a) provides that, subject to the requirements of FINRA Rule 5130,⁹ a member of a selling syndicate or selling group is permitted to sell securities in the offering to an affiliated person, provided the member does not sell the securities to the affiliated person at a reduced price as set forth under the rule. FINRA Rule 5141.03 provides that transactions between a member of a selling syndicate or selling group and an affiliated person that are part of the normal and ordinary course of business and are unrelated to the sale or purchase of securities in a fixed price offering shall not be deemed to confer a reduced price under the new rule.

Research

FINRA Rule 5141.02 states that nothing in the new rule prohibits a member or person associated with a member that participates in a selling syndicate or selling group from selling securities in the offering to a person or account to which it has provided or will provide research, as long as the person or account pays the stated public offering price for the securities and the research is provided pursuant to the requirements of Section 28(e) of the Exchange Act. The rule provides that investment management or investment discretionary services are not research for purposes of the provision. The rule further requires that any product or service provided by a member or person associated with a member that does not qualify as research must not confer a reduced price as set forth under FINRA Rule 5141.01 (see above).

Investment Advisers

FINRA Rule 5141.05 permits a member that is an investment adviser to exempt securities that are purchased as part of a fixed price offering from the calculation of annual or periodic asset-based fees that the member charges a customer, provided the exemption is part of the member's normal and ordinary course of business with the customer and is not in connection with an offering.

Endnotes

- 1 For more information, see Securities Exchange Act Release No. 62539 (July 21, 2010), 75 FR 44033 (July 27, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2010-029).
- 2 The current FINRA rulebook consists of: (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA member firms, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The FINRA Rules apply to all FINRA member firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see *Information Notice 03/12/08* (Rulebook Consolidation Process).
- 3 Effective February 8, 2011, NASD Rules 0120(h), 2730, 2740 and 2750, and NASD IM-2730, IM-2740 and IM-2750 will be deleted from the Transitional Rulebook.
- 4 FINRA Rule 5141.04—transferred from NASD Rule 0120(h) in substantially identical form—defines “fixed price offering” to mean the offering of securities at a stated public offering price or prices, all or part of which securities are publicly offered in the United States or any territory thereof, whether or not registered under the Securities Act, except that the term does not include offerings of “exempted securities” or “municipal securities” as those terms are defined in Sections 3(a)(12) and 3(a)(29), respectively, of the Exchange Act or offerings of redeemable securities of investment companies registered pursuant to the Investment Company Act which are offered at prices determined by the net asset value of the securities.
- 5 FINRA Rule 5141(b) provides that nothing in the rule prohibits the purchase and sale of securities in a fixed price offering between members of the selling syndicate or selling group. The terms “selling group” and “selling syndicate” are defined in NASD Rules 0120(p) and (q), respectively, and will be addressed later in the rulebook consolidation process. Other than to reflect the new conventions of the Consolidated FINRA Rulebook, FINRA does not plan to alter these two definitions.

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Endnotes

- 6 NASD Rule 0120(n), which will be addressed later in the rulebook consolidation process, defines “person” to include any natural person, partnership, corporation, association or other legal entity. Other than to reflect the new conventions of the Consolidated FINRA Rulebook, FINRA does not plan to alter this definition.
- 7 The new rule’s requirements also apply to any member or person associated with a member that acts as the single underwriter in connection with a fixed price offering. For convenience, all references in this *Notice* to requirements that apply to the selling syndicate or selling group include single underwriters. See FINRA Rules 5141(a), 5141.02 and 5141.03; see also 75 FR 44033 at 44034.
- 8 FINRA Rule 5141.01 provides that “fair market price” refers generally to a price or range of prices at which a buyer and a seller, each unrelated to the other, would purchase the securities in the ordinary course of business in transactions that are of similar size and similar characteristics and are independent of any other transaction. FINRA notes that this definition of “fair market price” is solely for purposes of FINRA Rule 5141 and is not intended to affect any other provisions with respect to pricing that are set forth in the FINRA rulebook.
- 9 FINRA Rule 5130 (former NASD Rule 2790) addresses restrictions on the purchase and sale of initial equity public offerings. The rule generally prohibits sales to and purchases by a broker-dealer and accounts in which a broker-dealer has a beneficial interest.

ATTACHMENT A

Below is the text of new FINRA Rule 5141.

* * * * *

5141. Sale of Securities in a Fixed Price Offering

(a) No member or person associated with a member that participates in a selling syndicate or selling group or that acts as the single underwriter in connection with a fixed price offering shall offer or grant, directly or indirectly, to any person or account that is not a member of the selling syndicate or selling group or that is a person or account other than the single underwriter any securities in the offering at a price below the stated public offering price (“reduced price”). Subject to the requirements of Rule 5130, a member of a selling syndicate or selling group, or a member that acts as the single underwriter, is permitted to sell securities in the offering to an affiliated person, provided such member does not sell the securities to the affiliated person at a reduced price under this Rule. The requirements of this Rule shall apply until the termination of the offering or until a member, having made a bona fide public offering of the securities, is unable to continue selling such securities at the stated public offering price. For purposes of this Rule, securities in a fixed price offering shall be presumed salable if the securities immediately trade in the secondary market at a price or prices which are above the stated public offering price.

(b) Nothing in this Rule shall prohibit the purchase and sale of securities in a fixed price offering between members of the selling syndicate or selling group.

• • • Supplementary Material: -----

.01 Reduced Price. For the purposes of this Rule, “reduced price” includes, without limitation, any offer or grant of any selling concession, discount or other allowance, credit, rebate, reduction of any fee (including any advisory or service fee), any sale of products or services at prices below reasonable commercially available rates for similar products and services (except for research subject to Rule 5141.02), or any purchase of or arrangement to purchase securities from the person or account at more than their fair market price in exchange for securities in the offering. For purposes of this Supplementary Material, “fair market price” refers generally to a price or range of prices at which a buyer and a seller, each unrelated to the other, would purchase the securities in the ordinary course of business in transactions that are of similar size and similar characteristics and are independent of any other transaction.

.02 Research. Nothing in this Rule shall prevent a member or person associated with a member that participates in a selling syndicate or selling group, or a member that acts as the single underwriter, from selling securities in the offering to a person or account to which it has provided or will provide research, provided the person or account pays the stated public offering price for the securities and the research is provided pursuant to the requirements of Section 28(e) of the Exchange Act. Investment management or investment discretionary services are not research for purposes of this Supplementary Material. Any product or service provided by a member or person associated with a member that does not qualify as research under this Supplementary Material must not confer a reduced price as set forth in Rule 5141.01.

.03 Affiliated Persons. Transactions between a member of a selling syndicate or selling group, or between a member that acts as the single underwriter, and an affiliated person that are part of the normal and ordinary course of business and are unrelated to the sale or purchase of securities in a fixed price offering shall not be deemed to confer a reduced price under this Rule.

.04 Fixed Price Offering. The term “fixed price offering” means the offering of securities at a stated public offering price or prices, all or part of which securities are publicly offered in the United States or any territory thereof, whether or not registered under the Securities Act, except that the term does not include offerings of “exempted securities” or “municipal securities” as those terms are defined in Sections 3(a)(12) and 3(a)(29), respectively, of the Exchange Act or offerings of redeemable securities of investment companies registered pursuant to the Investment Company Act which are offered at prices determined by the net asset value of the securities.

.05 Asset-Based Fees. A member that is an investment adviser may exempt securities that are purchased as part of a fixed price offering from the calculation of annual or periodic asset-based fees that such member charges to a customer, provided such exemption is part of the member’s normal and ordinary course of business with the customer and is not in connection with an offering.

* * * * *

Short Sales

Amendments to FINRA Trade Reporting and OATS Rules to Reinstitute Short Sale Exempt Marking and to Require Price and Short Exempt Identifier on Route Reports

Effective Date: November 10, 2010

Executive Summary

The SEC has approved a FINRA rule change that, among other things, reinstates the short sale exempt marking category for trade reports to a FINRA trade reporting facility (TRF) or to FINRA's Alternative Display Facility (ADF) (together, "FINRA Facilities"). The rule change also requires FINRA Order Audit Trail System (OATS) route reports to include price and a short exempt identifier, if applicable.¹ The amendments are effective on November 10, 2010,² consistent with the compliance date of the amendments to SEC Regulation SHO.³

The text of the amendments are available in the *FINRA Manual* at www.finra.org/finramanual.

Questions regarding this *Notice* should be directed to:

- FINRA Operations at (866) 776-0800; or
- OATS Helpdesk at (800) 321-6273
- Racquel Russell, Assistant General Counsel, Office of General Counsel, at (202) 728-8363.

October 2010

Notice Type

- Rule Amendment

Suggested Routing

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

Key Topics

- OATS
- Short Sales
- Trade Reporting

Referenced Rules

- FINRA Rule 6182
- FINRA Rule 6282
- FINRA Rule 6380A
- FINRA Rule 6380B
- FINRA Rule 6622
- FINRA Rule 7230A
- FINRA Rule 7230B
- FINRA Rule 7330
- FINRA Rule 7440
- NASD IM-2110-2

Background and Discussion

On February 26, 2010, the SEC adopted amendments to Regulation SHO that, among other things, implement a short-sale circuit breaker for NMS stocks⁴ triggered by a 10 percent or more decrease in the price of the security from the security's closing price at the end of regular trading hours on the prior trading day. Once a circuit breaker is triggered, Regulation SHO, as amended, generally requires trading centers to establish, maintain and enforce written policies and procedures reasonably designed to prevent the execution or display of short sale orders of an NMS stock at a price that is less than or equal to the current national best bid (NBB) for the remainder of the day and the following day, unless an exemption applies ("short sale price test restriction").⁵

As amended, Regulation SHO provides several exemptions to the short sale price test restriction and sets forth provisions under which a short sale order may be marked "short exempt." These provisions include:

- ▶ broker-dealer policies and procedures;
- ▶ seller's delay in delivery;
- ▶ odd lot transactions;
- ▶ domestic arbitrage;
- ▶ international arbitrage;
- ▶ over-allotments and lay-off sales;
- ▶ riskless principal transactions; and
- ▶ transactions on a volume-weighted average price basis (or VWAP).⁶

Consistent with these amendments to Regulation SHO, FINRA is reinstating the "short sale exempt" marking category in FINRA's trade reporting rules for over-the-counter transactions in NMS stocks. Thus, firms must indicate on trade reports submitted to a FINRA Facility if a transaction is "short exempt," consistent with Regulation SHO.⁷

In addition, the OATS rules have been amended to provide that, when an order is received or originated, firms must record the designation of the order as "short sale exempt" if the order is marked "short exempt" for Regulation SHO purposes. The amendments also require that firms include on route reports, if applicable, the price at which the order is routed and a short exempt identifier.⁸

On October 6, 2010, SEC staff issued *Responses to Frequently Asked Questions Concerning Rule 201 of Regulation SHO* (the SEC Rule 201 FAQ) that address, among other things, a firm's compliance obligations under self-regulatory organization customer order protection rules when a short sale price test restriction is in effect. In cases where a firm is short in a security and buys shares of that security during a short sale price test restriction (at a price that would trigger a fill of a customer limit order to buy under NASD IM-2110-2), SEC staff stated that the firm must fill the customer order (by selling short to the customer), regardless of whether such sale would meet the requirements of the price test restrictions of Rule 201 of Regulation SHO.⁹ The *SEC Rule 201 FAQ* further provides that, in this instance, the firm may mark the short sale order to fill the customer limit order as "short exempt."

The *SEC Rule 201 FAQ* also clarifies, among other things, that where a customer limit order to sell short at the NBB is triggered by a firm's long sale at the NBB in the same security, the firm's long sale would not require the execution of the customer's short sale limit order because the customer's limit order would not have been executable under Rule 201 (because it is a short sale priced at the NBB).¹⁰

These amendments to FINRA rules are effective on November 10, 2010, consistent with the compliance date of the amendments to SEC Regulation SHO.

Endnotes

- 1 See Securities Exchange Act Release No. 63032 (October 4, 2010), 75 FR 62439 (October 8, 2010) (Order Approving SR-FINRA-2010-043).
- 2 As noted in the *OATS Reporting Technical Specifications* dated August 30, 2010, the new fields will be required on OATS route reports beginning on November 8, 2010; however, members are not required to populate the fields until November 10, 2010. If a firm populates the fields prior to November 10, 2010, all relevant field validations will apply. Firms should consult the *OATS Reporting Technical Specifications* for more information. See also *OATS Frequently Asked Questions*, Question C85.
- 3 The amendments to Regulation SHO became effective on May 10, 2010 with a compliance date of November 10, 2010.
- 4 "NMS stock" means any "NMS security" other than an option. See 17 CFR 242.600(b)(47). Rule 600(b)(46) of SEC Regulation NMS defines "NMS security" as any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options. See 17 CFR 242.600(b)(46).

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Endnotes

- 5 See Securities Exchange Act Release No. 61595 (February 26, 2010), 75 FR 11232 (March 10, 2010) (Adopting Release for Regulation SHO, as amended).
- 6 SEC staff has indicated that firms may use the existing weighted average price (W) trade reporting modifier to satisfy the requirement in the VWAP exception that the transaction be reported using a special VWAP trade modifier. See Rule 201(d)(7) of Regulation SHO. The use of the W modifier would be in addition to the requirement to report the trade as “short sale exempt.”
- 7 Generally, FINRA expects firms to report transactions to FINRA Facilities in a manner that is consistent with the marking of the order for the purposes of Regulation SHO. However, we understand that, in some cases, the status of an order may change between the time of order origination and execution such that the trade report is marked differently than the order (*e.g.*, a circuit breaker is triggered or the NBB changes). If the trade report differs from the order, members must be prepared to provide, upon request from FINRA, documentation or evidence as to the reason for the difference.
- 8 Whenever a firm transmits an order to another member firm, electronic communications network, non-member firm or national securities exchange for handling or execution, the routing firm is responsible for recording and reporting a route report to OATS. As amended, the OATS rules require route reports to include the price at which the order was routed, which may be different from the price received from the customer, and whether the routed order is short exempt.

The short exempt identifier is important for purposes of route reports because certain short sale orders will be eligible to be marked exempt solely as a result of the timing and price of the routed order. See Rule 201(c) of SEC Regulation SHO. As of November 10, 2010, firms are also required to indicate the order type on route reports (*i.e.*, whether the order is a limit order and, consequently, requires that the limit price be included on the route report). For a complete description of these and other changes to OATS that go into effect on November 10, 2010, firms should consult the [*OATS Reporting Technical Specifications*](#) on FINRA’s website.
- 9 See Question # 8.1 of the [*SEC Rule 201 FAQ*](#).
- 10 See Question # 8.2 of the [*SEC Rule 201 FAQ*](#).

SEC Approves New Consolidated FINRA Rules

SEC Approval and Effective Date for New Consolidated FINRA Rules

Effective Date: December 15, 2010

Executive Summary

Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA established a process to develop a new consolidated rulebook (Consolidated FINRA Rulebook), which FINRA has discussed in previous *Information Notices*.¹ FINRA is proposing new consolidated rules in phases for approval by the Securities and Exchange Commission (SEC) as part of the Consolidated FINRA Rulebook.²

In August and September 2010, the SEC approved three rule filings relating to the Consolidated FINRA Rulebook. FINRA Rule 5121 (Public Offerings of Securities With Conflicts of Interest) and the FINRA Rule 11000 Series (Uniform Practice Code) will take effect on December 15, 2010. The effective date of FINRA Rule 3270 (Outside Business Activities of Registered Persons) is also December 15, 2010; however, for registered persons who are actively engaged in an outside business activity prior to December 15, 2010, firms have until June 15, 2011, to review such pre-existing activities under the standards set forth in FINRA Rule 3270, including the requirement that firms keep a record of their compliance with such standards.

October 2010

Notice Type

- Consolidated Rulebook
- Rule Approvals

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management

Key Topic(s)

- Effective Dates of Consolidated Rules
- FINRA Manual
- Rulebook Consolidation
- Outside Business Activities
- Public Offerings
- Uniform Practice Code

Referenced Rules & Notices

- FINRA Rule 3270
- FINRA Rule 5121
- FINRA Rule 11000 Series
- Information Notice 03/12/08
- Information Notice 10/06/08
- Regulatory Notice 08-57

Questions regarding this *Notice* should be directed to:

- ▶ Kosha Dalal, Associate Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-6903 (regarding the FINRA Rule 11000 Series);
- ▶ Gary Goldsholle, Vice President and Associate General Counsel, OGC, at (202) 728-8104 (regarding FINRA Rule 3270); or
- ▶ Stan Macel, Assistant General Counsel, OGC, at (202) 728-8056 (regarding FINRA Rule 5121).

Discussion

In August and September 2010, the SEC approved the following new consolidated FINRA Rules as part of the Consolidated FINRA Rulebook:

- ▶ Rule 3270 (Outside Business Activities of Registered Persons)³
- ▶ Rule 5121 (Public Offerings of Securities With Conflicts of Interest)⁴
- ▶ Rule 11000 Series (Uniform Practice Code)⁵

The attachment to this *Notice* sets forth additional information regarding these new consolidated rules and includes a hyperlink to each related rule filing. The filings provide, among other things, FINRA's statement of the purpose of the rule changes and an exhibit showing the changes between the new rule text and the text of the NASD rule as it exists in the Transitional Rulebook. Also, the text of the new FINRA rule is available in the online *FINRA Manual* at www.finra.org/finramanual.⁶

Rule Conversion Charts

As discussed in additional detail in *Information Notice 10/06/08* and *Regulatory Notice 08-57*, FINRA has posted three Rule Conversion Charts on its website to help firms become familiar with the new rules and show how the new rules relate to the NASD and/or Incorporated NYSE Rules in the Transitional Rulebook that they will replace.

Firms should be aware that the charts are intended as a reference aid only. FINRA reminds firms that the charts do not in any way serve as a substitute for diligent review of the relevant new rule language. The Rule Conversion Charts are located at www.finra.org/ruleconversionchart.

Endnotes

- 1 See *Information Notice 10/06/08* (Rulebook Consolidation Process: Effective Dates of New Consolidated Rules; Introduction of Rule Conversion Chart); see also *Information Notice 03/12/08* (Rulebook Consolidation Process).
- 2 The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA member firms, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The new FINRA Rules apply to all member firms, unless such rules have a more limited application by their terms. As the Consolidated FINRA Rulebook expands with the SEC's approval and with the new FINRA Rules taking effect, the rules in the Transitional Rulebook that address the same subject matter of regulation will be eliminated. When the Consolidated FINRA Rulebook is completed, the Transitional Rulebook will have been eliminated in its entirety.
- 3 See Exchange Act Release No. 62762 (Aug. 23, 2010), 75 FR 53362 (Aug. 31, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-042).
- 4 See Exchange Act Release No. 62702 (Aug. 12, 2010), 75 FR 51147 (Aug. 18, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2010-026).
- 5 See Exchange Act Release No. 62842 (Sept. 3, 2010), 75 FR 55842 (Sept. 14, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2010-030).
- 6 FINRA updates the rule text on its online *Manual* within two business days of SEC approval of changes to the rule text.

ATTACHMENT A

List of Approved FINRA Rules (and Related Rule Filings)

The SEC approved the following rule filings relating to the Consolidated FINRA Rulebook in August and September 2010. The effective date for FINRA Rule 5121 (Public Offerings of Securities With Conflicts of Interest) and the FINRA Rule 11000 Series (Uniform Practice Code) is December 15, 2010. The effective date of FINRA Rule 3270 (Outside Business Activities of Registered Persons) is also December 15, 2010; however, for registered persons who are actively engaged in an outside business activity prior to December 15, 2010, firms have until June 15, 2011, to review such pre-existing activities under the standards set forth in FINRA Rule 3270, including the requirement that firms keep a record of their compliance with such standards.

FINRA Rule Filing SR-FINRA-2009-042

www.finra.org/rulefilings/2009-042

The rule change adopts, with certain modifications, NASD Rule 3030 (Outside Business Activities of an Associated Person) as FINRA Rule 3270 (Outside Business Activities of Registered Persons) in the Consolidated FINRA Rulebook, and deletes Incorporated NYSE Rule 346 (Limitations – Employment and Association with Members and Member Organizations) and its Interpretation.

FINRA Rule 3270 prohibits any registered person from being an employee, independent contractor, sole proprietor, officer, director or partner of another person, or being compensated, or having the reasonable expectation of compensation, from another person as a result of any business activity outside the scope of the relationship with his or her member firm, unless he or she has provided prior written notice to the firm in the form specified by the firm. Passive investments and activities subject to the requirements of NASD Rule 3040 are exempted from this requirement.

Supplementary Material .01 (Obligations of Member Receiving Notice) to FINRA Rule 3270 sets forth the obligations of a member upon receipt of a written notice of a proposed outside business activity. FINRA Rule 3270 requires that, upon receipt of a written notice, a firm must consider whether the proposed activity will: (1) interfere with or otherwise compromise the registered person's responsibilities to the firm and/or the firm's customers or (2) be viewed by customers or the public as part of the firm's business based upon, among other factors, the nature of the proposed activity and the manner in which it will be offered. Additionally, based on the firm's review of such factors, the firm must evaluate the advisability of imposing specific conditions or limitations on a registered person's outside business activity, including where circumstances warrant, prohibiting the activity. A firm also must evaluate the proposed activity to determine whether the activity properly is characterized as an outside business activity or whether it should be treated as an outside securities activity

subject to the requirements of NASD Rule 3040. A firm must keep a record of its compliance with these obligations with respect to each written notice received and must preserve this record for the period of time and accessibility specified in Exchange Act Rule 17a-4(e)(1).

Rule/Series No.	Rule Title
Rule 3000 Series	SUPERVISION AND RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS
Rule 3200 Series	RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS
Rule 3270	Outside Business Activities of Registered Persons

FINRA Rule Filing SR-FINRA-2010-026

www.finra.org/rulefilings/2010-026

The rule change adopts NASD Rule 2720 (Public Offerings of Securities With Conflicts of Interest) as FINRA Rule 5121 in the Consolidated FINRA Rulebook.

Rule 5121 governs public offerings of securities in which a firm with a conflict of interest participates. It generally prohibits a firm with a “conflict of interest,” as defined in the rule, from participating in a public offering, unless certain other requirements are met. Such requirements include prominent disclosure of the nature of the conflict, and in certain circumstances, the participation of a qualified independent underwriter. Firms also must comply with certain net capital, discretionary accounts and filing requirements, as applicable.

Rule/Series No.	Rule Title
Rule 5000 Series	SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES
Rule 5100 Series	SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION
Rule 5120 Series	Offerings of Members’ Securities
Rule 5121	Public Offerings of Securities With Conflicts of Interest

FINRA Rule Filing SR-FINRA-2010-030

www.finra.org/rulefilings/2010-030

The rule change adopts NASD Rule 11000 Series (Uniform Practice Code (UPC)), with certain changes, as FINRA Rule 11000 Series in the Consolidated FINRA Rulebook. The rule change also deletes NASD Rule 3370 (Purchases) and the following corresponding provisions in the Incorporated NYSE Rules and Interpretations:

- 176 (Delivery Time);
- 180 (Failure to Deliver);
- 282 (Buy-in Procedures) and its Supplementary Material paragraphs .10 - .80; 291 (Failure to Fulfill Closing Contract);
- 292 (Restrictions on Members' Participation in Transaction to Close Defaulted Contracts);
- 293 (Closing Contracts in Suspended Securities);
- 294 (Default in Loan of Money);
- 387 (COD Orders) and its Supplementary Material paragraphs .10 - .60;
- Rule 387 Interpretations /01 - /18; 430 (Partial Delivery of Securities to Customers on C.O.D. Purchases); and
- Rule 430 Interpretation /01.

The UPC prescribes the manner in which over-the-counter securities transactions other than those cleared through a registered clearing agency are compared, cleared and settled between member firms. As a general matter, the UPC does not apply to:

- transactions in securities between firms that are compared, cleared or settled through the facilities of a registered clearing agency, except to the extent that the rules of the clearing agency provide that rules of other organizations shall apply;
- transactions in securities exempted under Section 3(a)(12) of the Exchange Act or municipal securities as defined in Section 3(a)(29) of the Exchange Act;
- transactions in redeemable securities issued by companies registered under the Investment Company Act of 1940, except for secondary market transactions between members in unit investment trusts; and
- transactions in Direct Participation Program securities, except as otherwise provided in the UPC.

Much of the NASD Rule 11000 Series has been transferred with minor changes into the Consolidated FINRA Rulebook, to update certain references and terminology.¹ FINRA Rules 11111 (Refusal to Abide by Rulings of the Committee) and 11112 (Review by Panels of the UPC Committee) consolidate and clarify the scope of reviews by the UPC Committee. FINRA Rules 11820 (Selling-Out), 11860 (COD Orders), 11810 (Buying-In) and 11810.03 (Sample Buy-In Forms) harmonize the differences between the corresponding NYSE rules and the NASD rules and update certain procedures and time frames. New FINRA Rule 11810(b)(4) (Notice of “Buy-In” and Confirmation of Receipt) provides that a seller that receives notice of a “buy-in” must reject it in the manner and time frame provided or will be deemed to have accepted such notice.

FINRA Rules 11870 (Customer Account Transfer Contracts) and 11870.03 (Sample Transfer Instruction Forms) incorporate certain guidance from NYSE Rule 412 (Customer Account Transfer Contracts).²

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- 1 NASD Rules 11890 (Clearly Erroneous Transactions), IM-11890-1 (Refusal to Abide by Rulings) and IM-11890-2 (Review by Panels of the UPC Committee) were adopted, with significant changes, into the Consolidated FINRA Rulebook as the FINRA Rule 11890 Series (Clearly Erroneous Transactions) pursuant to a separate rule filing and were not addressed as part of this rule filing. *See* Exchange Act Release No. 61080 (Dec. 1, 2009), 74 FR 64117 (Dec. 7, 2009) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-068).
 - 2 FINRA eliminated NYSE Rule 412 and its interpretations from the Transitional Rulebook as part of a rule change to reduce regulatory duplication for Dual Members during the period before completion of the Consolidated FINRA Rulebook. *See* Exchange Act Release No. 58533 (Sept. 12, 2008), 73 FR 54652 (Sept. 22, 2008) (Order Approving Proposed Rule Change; File No. SR-FINRA-2008-036). The NYSE subsequently amended its version of NYSE Rule 412 to state that NYSE members and member organizations shall comply with NASD Rule 11870, concerning the transfer of customer accounts between members, and any amendments thereto, as if such rule is part of the NYSE’s rules.

Rule/Series No.	Rule Title
Rule 11000 Series	UNIFORM PRACTICE CODE (“UPC”)
Rule 11100	Scope of Uniform Practice Code
Rule 11110	Committees
Rule 11111	Refusal to Abide by Rulings of the Committee
Rule 11112	Review by Panels of the UPC Committee
Rule 11120	Definitions
Rule 11121	Trade Date
Rule 11130	When, As and If Issued/Distributed Contracts
Rule 11140	Transactions in Securities “Ex-Dividend,” “Ex-Rights” or “Ex-Warrants”
Rule 11150	Transactions “Ex-Interest” in Bonds Which Are Dealt in “Flat”
Rule 11160	“Ex” Liquidating Payments
Rule 11170	Transactions in “Part-Redeemed” Bonds
Rule 11190	Reconfirmation and Pricing Service Participants
Rule 11200 Series	COMPARISONS OR CONFIRMATIONS AND “DON’T KNOW NOTICES”
Rule 11210	Sent by Each Party
Rule 11220	Description of Securities
Rule 11300 Series	DELIVERY OF SECURITIES
Rule 11310	Book-Entry Settlement
Rule 11320	Dates of Delivery
Rule 11330	Payment
Rule 11340	Stamp Taxes
Rule 11350	Part Delivery
Rule 11360	Units of Delivery
Rule 11361	Units of Delivery — Stocks
Rule 11362	Units of Delivery — Bonds
Rule 11363	Units of Delivery — Unit Investment Trust Securities
Rule 11364	Units of Delivery — Certificates of Deposit for Bonds
Rule 11365	Trading Securities As “Units” or Bonds “With Stock”
Rule 11400 Series	DELIVERY OF SECURITIES WITH DRAFT ATTACHED
Rule 11410	Acceptance of Draft

Rule/Series No.	Rule Title
Rule 11500 Series	DELIVERY OF SECURITIES WITH RESTRICTIONS
Rule 11510	Delivery of Temporary Certificates
Rule 11520	Delivery of Mutilated Securities
Rule 11530	Delivery of Securities Called for Redemption or Which Are Deemed Worthless
Rule 11540	Delivery Under Government Regulations
Rule 11550	Assignments and Powers of Substitution; Delivery of Registered Securities
Rule 11560	Certificate of Company Whose Transfer Books Are Closed
Rule 11570	Certificates in Various Names
Rule 11571	Certificate in Name of Corporation
Rule 11572	Certificate in Name of Firm
Rule 11573	Certificate in Name of Dissolved Firm Succeeded by New Firm
Rule 11574	Certificate in Name of Deceased Person, Trustee, etc.
Rule 11580	Transfer of Limited Partnership Securities
Rule 11581	Limited Partnership Transfer Forms
Rule 11600 Series	DELIVERY OF BONDS AND OTHER EVIDENCES OF INDEBTEDNESS
Rule 11610	Liability for Expenses
Rule 11620	Computation of Interest
Rule 11630	Due-Bills and Due-Bill Checks
Rule 11640	Claims for Dividends, Rights, Interest, etc.
Rule 11650	Transfer Fees
Rule 11700 Series	RECLAMATIONS AND REJECTIONS
Rule 11710	General Provisions
Rule 11720	Irregular Delivery — Transfer Refused — Lost or Stolen Securities
Rule 11721	Obligations of Members Who Discover Securities in Their Possession to Which They Are Not Entitled
Rule 11730	Called Securities
Rule 11740	Marking to the Market
Rule 11800 Series	CLOSE OUT PROCEDURES
Rule 11810	Buy-In Procedures and Requirements
Rule 11820	Selling-Out
Rule 11830	Reserved
Rule 11840	Rights and Warrants
Rule 11860	COD Orders
Rule 11870	Customer Account Transfer Contracts
Rule 11880	Settlement of Syndicate Accounts
Rule 11900	Clearance of Corporate Debt Securities

Continuing Education

Securities Industry/Regulatory Council on Continuing Education Issues Firm Element Advisory Update

The Securities Industry/Regulatory Council on Continuing Education (Council) has released its Fall 2010 Firm Element Advisory (FEA). The Council produces the FEA to identify regulatory and sales practice topics that firms should consider in their Firm Element training plans. Topics updated or added since the prior FEA are indicated in the document as such.

The updated FEA is available at www.cecouncil.com/publications/council_publications/FEA_Semi_Annual_Update.pdf.

The FEA topics are not exhaustive and are intended as a guide to firms when they determine what to include in their training plans. Firms should consider the specific nature of their business, clients, products and services when creating their training plans.

In addition to the FEA, the Council offers the Firm Element Content Builder, a Web-based tool that can assist firms in developing their Firm Element training plans. It enables users to search an extensive database of regulatory resources related to specific investment products or services and is available at www.cecouncil.com/firm_element/organizer.

Questions concerning this *Notice* should be directed to:

- cecounciladmin@finra.org; or
- Roni Meikle, Director, Continuing Education, FINRA, at (646) 315-8688.

October 2010

Notice Type

- Guidance

Suggested Routing

- Compliance
- Continuing Education
- Legal
- Registration
- Senior Management

Key Topics

- Continuing Education
- Firm Element

Commodity Futures-Linked Securities

Sales Practice Obligations for Commodity Futures-Linked Securities

Executive Summary

Securities that offer exposure to commodities have become increasingly popular and accessible to retail investors in recent years. Given the practical difficulties that can be associated with investing directly in many commodities, commodity-linked securities often use futures contracts to track an underlying commodity or commodity index. Commodity futures-linked securities can be an effective tool for gaining exposure to an asset class that in some cases can be difficult for retail investors to access. However, firms should be aware that, in some cases, the performance of the commodity futures-linked security can deviate significantly from the performance of the referenced commodity, especially over longer periods. The deviation could be either positive or negative, depending on market conditions and the product's investment strategy. This deviation can produce unexpected results for investors who are not familiar with futures markets, or who mistakenly believe that commodity futures-linked securities are designed to track commodity spot prices.

FINRA is issuing this *Notice* to remind firms that offer commodity futures-linked securities that they must ensure that communications with the public about these securities are fair and balanced, that recommendations to customers are suitable, and that their registered representatives adequately understand and are able to inform their customers about these securities before they recommend them. To meet these obligations, firms must train registered personnel about the characteristics, risks, and rewards of each product before they allow registered persons to sell that product to investors. Firms must also have adequate written supervisory procedures and supervisory controls that are reasonably designed to ensure that sales of commodity futures-linked securities comply with the federal securities laws and applicable FINRA rules.

October 2010

Notice Type

- Guidance

Suggested Routing

- Advertising
- Compliance
- Legal
- Senior Management

Key Topics

- Commodity Futures-Linked Securities
- Communications with the Public
- Exchange-Traded Products
- Futures Contracts
- Suitability
- Supervision and Training

Referenced Rules & Notices

- Incorporated NYSE Rule 342
- NASD Rule 2210
- NASD Rule 2310
- NASD IM-2310-2(e)
- NASD Rule 3010
- NASD Rule 3012
- Regulatory Notice 09-31

Questions concerning this *Notice* should be directed to:

- ▶ Laura Gansler, Associate Vice President, Office of Emerging Regulatory Issues, at 202-728-8275; or
- ▶ Richard Vagnoni, Senior Economist, Office of Economic Analysis, at 202-728-6934

Background and Discussion

Commodity prices can be volatile. For example, the price of crude oil declined nearly 80 percent between July and December 2008; in the first six months of 2009, it rose nearly 50 percent. Nonetheless, some research suggests that investments in commodities can be a valuable part of an overall diversification strategy. Some investors may also be attracted to commodities as a hedge against inflation, or as a strategy for taking advantage of growth in emerging markets.

Over the past several years, the number of products designed to provide retail investors exposure to either a particular commodity or a diversified basket of multiple commodities has grown.¹ Given the practical difficulties associated with investing in some commodities, many products that offer exposure to commodities use futures contracts as their investment strategy. Standardized futures contracts are exchange-traded derivatives that guarantee delivery of a commodity on an agreed-upon date for an agreed-upon price. To avoid taking physical delivery of the commodity, commodity futures-linked securities that seek to provide investors with continuous exposure to commodities typically sell their next-to-expire contracts (those with the nearest delivery date) prior to expiration and replace them with contracts with more distant delivery dates—for example, those expiring in the next month. This is called rolling the position.

A futures contract reflects the expected value of the commodity upon delivery in the future, whereas the spot price reflects the immediate delivery value of the commodity.² The price movements of a futures contract are typically correlated with the movements of the spot price of the referenced commodity, but the correlation is generally imperfect and price moves in the spot market may not be reflected in the futures market (and vice versa). Prices for futures contracts with more distant delivery dates can differ from each other as well as the spot price.³ Futures and spot prices generally converge as the futures contract expiration approaches, and they should be equal upon expiration of the futures contract, which then becomes a contract for immediate delivery.

A commodity futures-linked security will typically roll its position before a contract's expiration and can face differing prices between the contract it sells and the new contract—for more distant delivery—that it buys. This difference is called the roll yield. In some cases a commodity futures-linked security will have to roll its position into a more expensive contract (that is, the contract that is sold has a lower price than the one with which it is replaced), resulting in a loss, or negative roll yield. This is typical of a futures market in contango, in which futures contracts with more distant delivery dates are more expensive.⁴ In other cases, it may roll its position into a less expensive contract (that is, the contract that is sold has a higher price than the one with which it is replaced), resulting in a gain, or positive roll yield. This is typical of a futures market in backwardation, in which futures contracts with more distant delivery dates are less expensive.⁵ Due to these and other market forces, commodity futures-linked securities can perform differently—either better or worse—than the spot price for the commodity itself.⁶ Moreover, over time, any performance differential can be magnified if a specific condition persists in the market for a given commodity, such as contango or backwardation. This deviation is not tracking error, because the futures-linked products are designed to track futures. However, it can lead to unexpected results for investors or registered representatives who do not understand the product, or who mistakenly believe that the product will replicate the performance of the commodity's spot price.

Commodity futures-linked securities can have different methodologies for achieving their investment objectives, and they may or may not employ strategies that address roll yield. Some invest in a single futures contract, often the one with the closest delivery date. Others invest in multiple contracts along the futures curve (*e.g.*, holding contracts for each of the next 12 months), which can allow them to diversify across different futures contracts. Others pursue more complicated investment strategies, such as tracking indices that attempt to optimize roll yield by minimizing the impact of contango or maximizing the impact of backwardation. Each strategy has different benefits, risks and costs, and the appropriateness of a particular methodology depends, in part, on an investor's needs and preferences.

Sales Practice Obligations

Firms have an obligation to understand the products they sell in order to ensure that their communications with the public about the products are fair, balanced, and not misleading, that their recommendations to customers are suitable, that customers are adequately informed about the product and that their sales force is adequately trained and supervised.

Under NASD Rule 2210, firms must ensure that all communications with the public are fair and balanced, and provide a sound basis for evaluating the facts about any particular security or type of security, industry or service. No firm may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communications to be misleading. In particular, firms should not suggest that a commodity-futures linked security offers direct exposure to the commodity's spot price, overstate the degree of correlation between the two or understate the risks inherent in investing in commodity futures. Firms should also not overstate the hedging value of commodity futures-linked products, or commodities generally, for, by example, implying that their performance is always negatively correlated with equities or other asset classes. The fact that a prospectus makes it clear that the goal of the product is to use futures to track the price of the commodity or index, or discloses that there is a potential for a performance gap between the futures and spot prices does not alleviate a firm's duty to ensure that its communications regarding the product are fair, balanced and not misleading.

In addition, NASD Rule 2310 requires that, before recommending the purchase, sale or exchange of a security, a firm must have a reasonable basis for believing that the transaction is suitable for the customer to whom the recommendation is made. NASD IM-2310-2(e) (Fair Dealing with Customers with Regard to Derivative Products or New Financial Products) emphasizes the obligation of firms to deal fairly with customers when making recommendations or accepting orders for new financial products. The IM states that "[a]s new products are introduced from time to time, it is important that members make every effort to familiarize themselves with each customer's financial situation, trading experience, and ability to meet the risks involved with such products and to make every effort to make customers aware of the pertinent information regarding the products." For commodity futures-linked securities, the registered representative and retail customer should discuss, among other things:

- ▶ the commodity, basket of commodities or commodities index that a given product tracks;
- ▶ the product's goals, strategy and structure;
- ▶ that commodities prices, and the performance of commodity futures-linked securities, can be volatile;

- that the use of futures contracts can affect the performance of the product as compared to the performance of the underlying commodity or index;
- the product's methodology, including its strategy, if any, for managing roll yield and other factors that may affect performance; and
- the product's tax implications. (Commodity pools have different tax implications than mutual funds or exchange-traded notes.)

The fact that commodity futures-linked securities can perform differently from the spot price of a given commodity does not mean that they are not suitable for any investor or that they cannot be effective investment vehicles. However, firms that sell commodity futures-linked securities must ensure that their registered representatives understand each product's goals, strategy and structure, and how those factors may affect the product's suitability for specific customers, given, among other things, the customers' investment objectives, investment horizons and tax status.

Training and Supervision

Firms that sell commodity futures-linked securities must provide adequate training to ensure that their registered persons understand the products they recommend, and that they describe them in a manner that is fair, balanced and not misleading. Firms must also train registered personnel about the characteristics, risks, and rewards of each product before they allow registered persons to sell that product to investors. In connection with such training, firms should train registered persons about how to make customers aware of the pertinent information regarding the products and train them about the factors that would make the products either suitable or unsuitable for certain investors. Training should not be limited to representatives selling such products. Firms should also provide appropriate training to supervisors of registered persons selling commodity futures-linked securities. Firms must also have adequate written supervisory procedures and supervisory controls that are reasonably designed to ensure that sales of commodity futures-linked securities comply with the federal securities laws and FINRA rules.⁷

Endnotes

- 1 One such example is the commodity-linked exchange-traded product (ETP). ETPs can be organized as, among other things, 1940 Act investment companies (*e.g.*, exchange-traded funds), commodity pools, grantor trusts, or exchange-traded notes. At the end of July 2010 there was over \$80 billion in commodity ETPs, or about 10 percent of total ETP assets, up from around \$60 billion at the same point in 2009. Other investment products offering retail investors exposure to commodities can include mutual funds and closed-end funds, structured notes linked to commodities, and hedge and managed futures funds. Some commodity-linked products offer leveraged or inverse exposure to the commodity or index they track. Leveraged and inverse commodity-linked products could present similar issues to those highlighted by FINRA in *Regulatory Notice 09-31* regarding non-traditional exchange-traded funds (ETFs).
- 2 A variety of factors can lead to a disparity between the expected future price of a commodity and the spot price at a given point in time, such as the cost of storing the commodity for the term of the futures contract, interest charges incurred to finance the purchase of the commodity, and expectations concerning supply and demand for the commodity.
- 3 The difference between the price of a futures contract and the spot price of a commodity is often referred to as the basis. The difference between prices for futures contracts with different expiration dates is often called the spread.
- 4 Contango does not necessarily lead to negative returns, but can be a drag on performance relative to the spot commodity. A futures market can experience contango because the price of the underlying commodity is expected to rise.
- 5 Backwardation does not necessarily lead to positive returns, but can boost performance relative to the spot commodity. A futures market can experience backwardation because the price of the underlying commodity is expected to decline.
- 6 The roll yield is only one factor that can cause the performance of a commodity futures-linked security to deviate from the performance of the spot price of a commodity. The previously noted imperfect correlation between futures and spot prices is another. Like any product that tracks an asset or index, other factors that can affect the performance of a futures-linked security include transaction costs, management fees and taxes.
- 7 See NASD Rules 3010 and 3012, and Incorporated NYSE Rule 342 and its related supplementary material and interpretations.

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Free Writing Prospectuses

Application of Rules on Communications With the Public and Institutional Sales Material and Correspondence to Certain Free Writing Prospectuses

Executive Summary

The content standards, the principal review requirements and applicable filing requirements in NASD Rules 2210 (Communications with the Public) and 2211 (Institutional Sales Material and Correspondence) shall apply to free writing prospectuses distributed by broker-dealers in a manner reasonably designed to lead to their broad unrestricted dissemination, as described in Securities Act Rule 433. By this Notice, FINRA is withdrawing, in part, previous interpretive guidance that excluded free writing prospectuses from the requirements of NASD Rules 2210 and 2211.

Questions regarding this *Notice* should be directed to:

- Joseph E. Price, Senior Vice President, Corporate Financing/Advertising Regulation, at (240) 386-4623; or
- Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8104.

Background and Discussion

This *Notice* addresses the application of NASD Rules 2210 and 2211 to free writing prospectuses distributed by broker-dealers in a manner reasonably designed to lead to their broad unrestricted dissemination, as described in Securities Act Rule 433.

October 2010

Notice Type

- Guidance

Suggested Routing

- Advertising
- Compliance
- Legal
- Operations
- Registered Representatives
- Senior Management

Key Topics

- Communications With the Public
- Free Writing Prospectus
- Supervision

Referenced Rules & Notices

- FINRA Rule 5110
- FINRA Rule 5120
- NASD Rule 2210
- NASD Rule 2211
- Securities Act Rule 164
- Securities Act Rule 405
- Securities Act Rule 433

Securities Act Rule 405 defines a free writing prospectus as a written communication, including an electronic communication, that constitutes an offer to sell or a solicitation to buy securities in a registered offering by means other than the statutory prospectus.¹ The free writing prospectus was introduced as part of the SEC's Securities Offering Reform² and was intended to provide issuers with greater flexibility in the use of communications during the registered offering process. A free writing prospectus may include information that is not included in the registration statement, but it may not conflict with information in the filed registration statement, including any prospectus and any Securities Exchange Act reports incorporated by reference.³ A free writing prospectus must contain a legend advising investors that:

- ▶ the issuer has filed a registration statement (including a prospectus) with the SEC for the offering to which the communication relates;
- ▶ before investing, the investor should read the prospectus and other documents filed by the issuer; and
- ▶ copies of these documents can be obtained for free through the SEC's website or from the issuer or any underwriter or dealer participating in the offering.⁴

Securities Act Rule 433 requires any offering participant other than the issuer to file any free writing prospectus that is distributed by or on behalf of the offering participant in a manner reasonably designed to lead to its broad unrestricted dissemination.⁵ Previously, FINRA issued interpretive guidance excluding free writing prospectuses from the requirements of NASD Rules 2210 and 2211.⁶ These NASD rules establish standards for the content of communications with the public by broker-dealers, which are designed to ensure that the communications are fair, balanced and not misleading. Rule 2210(b)(1) requires a registered principal to review and approve each advertisement and item of sales literature before it is distributed; this provision has helped ensure compliance with the content standards. Rule 2210(c)(2) requires that firms file advertisements and sales literature regarding certain types of securities, such as registered investment companies and public direct participation programs, with FINRA within 10 business days of first use.

Withdrawal of Previous Interpretive Guidance

By this *Notice*, FINRA is withdrawing previous interpretive guidance on free writing prospectuses that are distributed by a broker-dealer in a manner reasonably designed to lead to broad unrestricted dissemination.⁷ Since FINRA issued that guidance it has become apparent that a free writing prospectus that is distributed by a broker-dealer in a manner reasonably designed to lead to its broad unrestricted dissemination as described by Rule 433 presents the same investor protection concerns as communications regulated by NASD Rules 2210 and 2211. For example, FINRA has seen sales material that seemed to be in serious noncompliance with the content standards of Rule 2210, but was excluded from the application of that rule merely because the broker-dealer asserted that it constituted a free writing prospectus.

While our interpretive guidance was intended to promote the objectives of Rule 433, it has led to inconsistent regulatory treatment of communications that present similar investor protection concerns. For example, investment companies registered under the Investment Companies Act of 1940 are not eligible to use a free writing prospectus under Securities Act Rule 164(f). Thus, a communication concerning an exchange traded fund (ETF) that is a registered investment company must comply with the content, registered principal approval and filing requirements of Rule 2210. On the other hand, a free writing prospectus concerning an ETF that is not a registered investment company would be exempt from the application of Rule 2210.

Therefore, FINRA now interprets Rules 2210 and 2211 to apply to free writing prospectuses distributed by a broker-dealer in a manner reasonably designed to lead to broad unrestricted dissemination. These requirements include the content standards, the principal review requirement and any applicable filing requirement.⁸ FINRA notes that broker-dealers are already required to file such free writing prospectuses with the SEC, and, therefore, filing them with FINRA will not cause delays in the offering process.⁹

Scope of “Broad Unrestricted Dissemination”

The SEC has provided guidance concerning the meaning of the term “broad unrestricted dissemination” and FINRA explicitly incorporates that guidance. Specifically, the SEC has noted that examples of broad unrestricted dissemination of a free writing prospectus by a broker-dealer would include posting such prospectus on an unrestricted website or releasing it to the media.¹⁰ Conversely, the SEC has stated that a broker-dealer does not make a broad unrestricted dissemination if a free writing prospectus is posted to a restricted website or sent directly to its customers, regardless of the number of customers.¹¹

Endnotes

- 1 17 CFR 230.405.
- 2 Securities Exchange Act Release No. 52056 (July 19, 2005), 70 FR 44722 (August 3, 2005) (Order Approving SEC File No. S7-38-04, Securities Offering Reform).
- 3 17 CFR 230.433(c)(1).
- 4 17 CFR 230.433(c)(2).
- 5 17 CFR 230.433(d)(1)(ii). Well-known seasoned issuers and their offering participants, including underwriters, are permitted to use free writing prospectuses at any time. Other eligible issuers and their offering participants may use a free writing prospectus after a registration statement has been filed. Participants in offerings of the securities of non-reporting and unseasoned issuers are required in some instances to accompany or precede the free writing prospectus with the most recent statutory prospectus.
- 6 See Letter from Lisa C. Horrigan, Assistant General Counsel, NASD, to Eileen Ryan, Vice President and Associate General Counsel, Securities Industry Association, and Sarah Starkweather, Regulatory Counsel, The Bond Market Association (August 1, 2006), available at www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P017285.
- 7 This *Notice* does not withdraw the guidance in that letter pertaining to any free writing prospectus that is distributed by a broker-dealer in a manner that is *not* reasonably designed to lead to its broad unrestricted dissemination. Accordingly, free writing prospectuses continue to be exempt from the provisions of NASD Rules 2210 and 2211 to the extent they are *not* part of a broad unrestricted dissemination. This *Notice* also does not withdraw the guidance in that letter pertaining to NASD Rules 2710 and 2720 (now FINRA Rules 5110 and 5120).
- 8 For example, if a member uses such a free writing prospectus on behalf of a public direct participation program, the member must file the free writing prospectus with FINRA within 10 business days of first use. Free writing prospectuses for ETFs that are not registered investment companies are not subject to the filing requirements.
- 9 Rule 433(d)(1)(ii) requires filing with the SEC no later than the date of first use. When applicable, Rule 2210(c) generally requires filing with FINRA within 10 business days after first use or publication.
- 10 Securities Exchange Act Release No. 52056, *supra* at 2.
- 11 *Id.*

Regulatory Notice

10-53

Margin Requirements

Margin Requirements for Exempted Securities Mutual Funds and Exempted Securities ETFs

Effective Date: October 26, 2010

Executive Summary

Effective October 26, 2010, FINRA is advising firms of customer margin requirements for exempted securities mutual funds and exempted securities exchange traded funds (ETFs) in Regulation T margin accounts. FINRA is also reminding firms of customer margin requirements for money market mutual funds.

Questions concerning this *Notice* should be directed to:

- ▶ Rudolph R. Verra, Managing Director, Risk Oversight and Operational Regulation, at (646) 315-8811;
- ▶ Glen Garofalo, Director, Credit Regulation, at (646) 315-8464; or
- ▶ Steve Yannolo, Principal Credit Specialist, Credit Regulation, at (646) 315-8621.

Background & Discussion

An exempted securities mutual fund is defined in Section 220.2 of Regulation T, as “any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C.80a-8), provided that the company has at least 95% of its assets continuously invested in exempt securities (as defined in section 3(a)(12) of the [Exchange] Act.”

October 2010

Notice Type

- ▶ Guidance

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Margin Department
- ▶ Operations
- ▶ Regulatory Reporting
- ▶ Risk Management
- ▶ Senior Management

Key Topics

- ▶ Exchange Traded Funds (ETFs)
- ▶ Exempted Securities ETFs
- ▶ Exempted Securities Mutual Funds
- ▶ Leveraged Exempted Securities ETFs
- ▶ Margin Requirements
- ▶ Money Market Mutual Funds

Referenced Rules & Notices

- ▶ Incorporated NYSE Rule 431
- ▶ Investment Company Act of 1940
- ▶ NASD Rule 2520
- ▶ Regulation T
- ▶ Regulatory Notice 08-60
- ▶ Regulatory Notice 09-31
- ▶ Regulatory Notice 09-53
- ▶ SEA Section 3(a)(12)

ETFs are typically registered unit investment trusts (UITs) or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index. Some ETFs, similar to exempted securities mutual funds discussed above, have at least 95 percent of their assets continuously invested in exempt securities (exempted securities ETFs). Further, some exempted securities ETFs are leveraged ETFs that are designed to generate multiples (e.g., 200 percent, 300 percent or greater) of the performance of the underlying benchmark they track. FINRA reminded firms of the sales practice obligations with respect to leveraged ETFs in *Regulatory Notice 09-31* (June 2009).

Margin Requirements for Exempted Securities Mutual Funds and Exempted Securities ETFs

Regulation T, issued by the Board of Governors of the Federal Reserve Board pursuant to the Exchange Act, among other things, sets the initial amount of margin required for equity securities.¹ Regulation T excepts from this initial margin requirement selected types of securities, including exempted securities, money market mutual funds and exempted securities mutual funds, and provides that the margin for such products may be established by the creditor in good faith or by the regulatory authority, whichever is greater.² Pursuant to Regulation T, NASD Rule 2520(e)(2)(A) and (B) and Incorporated NYSE Rule 431(e)(2)(A) and (B) prescribe margin requirements for obligations for selected exempted securities (specifically for (1) government debt securities and (2) all other exempted securities).

FINRA has received several inquiries requesting clarification on the appropriate margin treatment for exempted securities mutual funds and exempted securities ETFs. Firms have questioned whether such products may be margined as equity securities or exempted securities.

Pursuant to NASD Rule 2520(f)(8)(A) and Incorporated NYSE Rule 431(f)(8)(A), FINRA is advising firms that the margin requirement for an exempted securities mutual fund and exempted securities ETF shall be commensurate with the margin requirements for other exempted securities. Accordingly, effective October 26, 2010, exempted securities mutual funds and exempted securities ETFs shall have an initial and maintenance requirement of 7 percent of the current market value for Regulation T margin accounts. In the case of a leveraged, exempted securities ETF, the initial and maintenance margin requirement in a Regulation T margin account shall increase by a percentage commensurate with the leverage of the ETF. For example, a 200 percent leveraged exempted securities ETF will have a maintenance requirement of 14 percent (2 x 7 percent). FINRA notes that it increased the maintenance margin requirements for leveraged ETFs as prescribed in *Regulatory Notice 09-53* that became effective on December 1, 2009.

FINRA believes that this margin treatment is appropriate in Regulation T margin accounts as such products are treated similarly in portfolio margin accounts. FINRA notes in portfolio margin accounts The Options Clearing Corporation applies comparable stress ranges for exempted securities ETFs. For example, ETFs comprised of U.S. Treasury and municipal debt securities are stressed +/- 7 percent.³

Money Market Mutual Funds Requirements

FINRA reminds firms that a money market mutual fund, as defined in Section 220.2 of Regulation T and excepted from Regulation T,⁴ has an initial and maintenance requirement of 1 percent of the current market value for both Regulation T margin accounts and portfolio margin accounts, provided the net asset value (NAV) of the fund is not below \$1.00 per share.⁵ If the NAV of a money market mutual fund falls below \$1.00 (*i.e.*, “breaks the buck”), firms must abide by the provisions promulgated in *Regulatory Notice 08-60*.

FINRA also reminds firms that before extending credit on money market mutual funds, they must ensure that (1) the customer waives any right to redeem the shares without the firm’s consent, (2) the firm (or if the shares are deposited with a clearing organization, the clearing organization) obtains the right to redeem the shares for cash upon request and (3) the fund agrees to satisfy any conditions necessary or appropriate to ensure that the shares may be redeemed for cash promptly upon request.⁶

Endnotes

- 1 See Regulation T Section 220.12(a).
- 2 See Regulation T Section 220.12(b).
- 3 For a list of ETFs, please see www.optionsclearing.com/components/docs/risk-management/rbh/bond_treasury_debt_etfs.pdf
- 4 A money market mutual fund means any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8) that is considered a money market mutual fund under SEC Rule 2a-7 (17 CFR 270.2a-7).
- 5 See *Regulatory Notice 08-60* (Money Market Mutual Funds).
- 6 See NASD Rule 2520(g)(7)(D) and Incorporated NYSE Rule 431(g)(7)(D).

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Disclosure of Services, Conflicts and Duties

FINRA Requests Comment on Concept Proposal to Require a Disclosure Statement for Retail Investors at or Before Commencing a Business Relationship

Comment Period Expires: December 27, 2010

Executive Summary

FINRA requests comment on a concept proposal to require member firms, at or prior to commencing a business relationship with a retail customer, to provide a written statement to the customer describing the types of accounts and services it provides, as well as conflicts associated with such services and any limitations on the duties the firm otherwise owes to retail customers.

Questions concerning this *Notice* should be directed to:

- Philip Shaikun, Associate Vice President, Office of General Counsel, at (202) 728-8451.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by December 27, 2010.

Member firms and other interested parties can submit their comments using the following methods:

- Emailing comments to pubcom@finra.org; or
- Mailing comments in hard copy to:

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

October 2010

Notice Type

- Request for Comment

Suggested Routing

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

Key Topics

- Conflicts of Interest

Referenced Rules & Notices

- NASD Rule 3110
- Regulatory Notice 09-34

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA website. Generally, FINRA will post comments on its site one week after the end of the comment period.¹

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.²

Background and Discussion

Even as the legislation that became the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was being developed, FINRA staff considered how it might implement a heightened standard of care with respect to broker-dealers. The staff determined that no matter how the ultimate contours of such a standard would be concluded, retail customers would benefit from an upfront disclosure document that sets forth in plain English a firm's accounts and services, its associated conflicts of interest and any limitations on duties owed to the customer. The staff conceived of a document similar in purpose to Form ADV, which is required under the Investment Advisers Act to be provided to each advisory customer. The staff believed that such a document would not only provide useful information to a retail customer, but also would help clearly define the scope of the duties owed to that customer.

With the enactment of Dodd-Frank, the staff believes the concept is even more appropriate, if not an outright necessity. The legislation requires the SEC to conduct a study of the obligations of broker-dealers and investment advisers, and authorizes subsequent SEC rulemaking to establish a fiduciary duty for broker-dealers. Notably, the study must consider the regulatory gaps between broker-dealer and investment adviser regulation, and the SEC has asked for comment as to how such gaps may be closed. Additionally, the legislation requires the SEC to facilitate simple and clear disclosures of material conflicts by both broker-dealers and investment advisers. Accordingly, in anticipation of satisfying any resultant rulemaking mandates and to enhance retail investors' understanding of the business, relationships and conflicts of their brokers, FINRA staff is seeking comment on the contours of a proposal that would require each firm to timely provide to retail customers a statement of services, conflicts and duties. Firms would continue to provide the more particularized sales practice disclosures currently required in interactions between registered representatives and customers.

As conceived by FINRA staff, a possible new rule proposal would require a firm, at or prior to commencing a business relationship with a retail customer, to provide to the customer a written statement that sets forth the types of brokerage accounts and services the firm provides to retail customers and the conflicts associated with such services. A “retail customer” would mean a customer that does not qualify as an institutional account under NASD Rule 3110(c)(4). The definition of “institutional account” under that rule consists of a bank, savings and loan, insurance company, registered investment company, registered investment adviser or any entity (which includes natural persons) with total assets of at least \$50 million.

FINRA staff further conceives that the document would include the following characteristics and subject matter:

- ▶ **The types of brokerage accounts and services the firm provides to retail customers, such as research, underwriting and recommendations of securities, products and strategies.**
- ▶ **Disclosures that are reasonably designed to permit existing and prospective retail customers of the firm to evaluate:**
 - ▶ the scope of services provided by the firm to its retail customers and any limitations on the scope of the services offered (e.g., that the universe of research covered may be limited or influenced by the issuers with which the firm maintains an investment banking relationship or the securities for which the firm acts as a market maker or otherwise engages in proprietary trading);
 - ▶ the scope of products offered to the firm’s retail customers;
 - ▶ to the extent applicable, that the firm may not offer all products of a certain class or type and that it or its affiliates may be the sponsor or originator of certain products and may determine in some cases to act as a distributor or placement or sales agent for a fee from the issuer or sponsor of the product; and
 - ▶ all fees associated with each brokerage account and service offered to retail customers, a specific description of the service provided for each fee and whether fees are negotiable presented in a manner to allow customers to make comparisons between broker-dealers.

- ▶ **Disclosures as to financial or other incentives that a firm or its registered representatives have to recommend certain products, investment strategies or services over similar ones, including:**
 - ▶ in the case of investment company securities, the information required by proposed FINRA Rule 2341(l)(4);³
 - ▶ any arrangement in which the firm receives any economic benefit (including cash, revenue sharing, commissions, equipment, research or non-research services) from any person, including an issuer or product manufacturer in connection with providing a particular product, investment strategy or service to a customer;
 - ▶ any arrangement in which the firm compensates or receives any economic incentive for customer referrals from or to any individual or firm; and
 - ▶ any arrangement in which a registered representative receives different payouts or other rates of compensation for certain products or services that are reasonably likely to provide an incentive for the registered representative to offer that product in lieu of similar products offered by the firm.

- ▶ **Disclosure of conflicts that may arise between a firm and its customers, as well as those that may arise in meeting the competing needs of multiple customers, and how the firm manages such conflicts.**

- ▶ **Limitations on the duties a firm owes to its customers; for example, that the firm:**
 - ▶ does not assure the ongoing suitability of an investment or portfolio of investments;
 - ▶ takes no responsibility for the propriety of unsolicited orders, other than to discharge its best execution obligation; or
 - ▶ may execute any transaction on a principal basis, absence instructions to act only in an agency capacity.

Request for Comment

FINRA staff welcomes all comments on the concept proposal. Among other things, FINRA staff is interested in comments on the following:

- Scope:** Is the proposal either overbroad or too narrow in the products, services and conflicts requiring disclosure?
- Delivery method:** Should the disclosure statement be delivered in writing in hard copy or made electronically available or both?
- Form and content:** How detailed should the disclosures be? How best to ensure meaningful disclosure without overwhelming retail investors? Should there be two-tiered disclosure, such as a general disclosure document with hyperlinks or website references where investors can obtain more detailed disclosures of a firm's products, services and attendant conflicts and limitations?
- Timing:** How often should a firm update and provide the disclosure statement to retail customers?

Endnotes

- 1 FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See NASD Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
- 2 Section 19 of the Securities Exchange Act of 1934 (SEA or Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. *See Exchange Act Section 19 and rules thereunder.*
- 3 *See Regulatory Notice 09-34* (June 2009).

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Trade Reporting and Compliance Engine (TRACE)

FINRA Establishes a New Effective Date for Reporting Asset-Backed Securities to TRACE and Related Rule Changes

Effective Date: May 16, 2011

Executive Summary

FINRA is establishing a new effective date of May 16, 2011, for reporting Asset-Backed Securities to TRACE.

Questions regarding this *Notice* should be directed to:

- Patrick Geraghty, Director, Market Regulation, at (240) 386-4973;
- Elliot R. Levine, Associate Vice President and Counsel, Transparency Services, at (202) 728-8405; or
- Sharon Zackula, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8985.

Discussion and Background

FINRA's TRACE Rules (the Rule 6700 Series) provide for the reporting of transactions in TRACE-Eligible Securities to TRACE and the dissemination of transaction information, with limited exceptions. TRACE reporting and data fees are set forth in FINRA Rule 7730.

October 2010

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Fixed Income
- Legal
- Operations
- Research
- Systems
- Trading

Key Topics

- Asset-Backed Securities
- Effective Date
- TRACE-Eligible Security

Referenced Rules & Notices

- FINRA Rule 6710
- FINRA Rule 6720
- FINRA Rule 6730
- FINRA Rule 6750
- FINRA Rule 6760
- FINRA Rule 7730
- Regulatory Notice 10-23

In February 2010, the SEC approved SR-FINRA-2009-065 (TRACE ABS filing), which:

- amends the TRACE Rules to classify asset-backed securities, mortgage-backed securities and other similar securities (collectively, Asset-Backed Securities) as TRACE-Eligible Securities;
- requires that transactions in Asset-Backed Securities be reported to TRACE;
- modifies certain other reporting requirements and notification provisions; and
- establishes reporting fees for transactions in Asset-Backed Securities.¹

In April 2010, FINRA published *Regulatory Notice 10-23*, which announced the SEC's approval of the TRACE ABS filing and established an effective date of February 14, 2011.

However, pursuant to this *Notice*, FINRA is establishing a new effective date of May 16, 2011, for the rule amendments in the TRACE ABS filing.² FINRA believes that an extended effective date will allow sufficient time to make additional systems enhancements and allow for coordinated testing of the technology.³

Endnotes

- 1 See Securities Exchange Act Release No. 61566 (February 22, 2010), 75 FR 9262 (March 1, 2010) (SEC Order Approving File No. SR-FINRA-2009-065) (TRACE ABS filing). See also Securities Exchange Act Release No. 61948 (April 20, 2010), 75 FR 22670 (April 29, 2010) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2010-019 to Extend the Implementation Period for SR-FINRA-2009-065).
- 2 See Securities Exchange Act Release No. 63223 (November 1, 2010), 75 FR 68654 (November 8, 2010) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2010-054 to Extend the Implementation Period for SR-FINRA-2009-065).
- 3 In *Regulatory Notice 10-23*, FINRA also announced that the six-month pilot program, during which the period to report a transaction in an Asset-Backed Security is extended from the date of trade during TRACE System Hours to T + 1 during TRACE System Hours, would end on Sunday, August 14, 2011, at 11:59:59 p.m., Eastern Time, based on the then designated effective date of February 14, 2011. Based on the new effective date of May 16, 2011, the pilot program will end on November 16, 2011.

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Trading Activity Fee

SEC Approves Amendments to the Trading Activity Fee and FINRA Announces Publication of Frequently Asked Questions

Effective Date: November 1, 2010

Executive Summary

Effective November 1, 2010, FINRA is removing the exemption from the Trading Activity Fee (TAF) for transactions in exchange-listed options effected by a member firm when FINRA is not the designated options examining authority for that firm.¹ Because FINRA now has sole regulatory responsibility for the public options activities of all of its member firms, the exemption is no longer necessary. FINRA is also issuing this *Notice* to announce publication on its website of Trading Activity Fee Frequently Asked Questions (FAQ), which provides guidance for firms on the assessment of the TAF. The TAF FAQ can be found at www.finra.org/taff/faq.

Questions concerning this *Notice* should be directed to:

- FINRA Finance, at (240) 386-5397; or
- The Office of General Counsel, at (202) 728-8071.

October 2010

Notice Type

- Guidance
- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Operations
- Options
- Senior Management
- Systems
- Trading

Key Topics

- Trading Activity Fee

Referenced Rules & Notices

- FINRA By-Laws, Schedule A, Section 1
- NTM 02-63
- NTM 02-75
- NTM 03-30
- NTM 05-03
- NTM 05-23
- NTM 06-37
- Regulatory Notice 08-37
- SEA Rule 17d-2

Background & Discussion

Amendments to the Trading Activity Fee

The TAF is one of the member regulatory fees FINRA uses to fund its member regulation activities, which include examinations, financial monitoring and FINRA's policymaking, rulemaking and enforcement activities. In 2003, FINRA created an exemption from the TAF for transactions in exchange-listed options effected by a member firm when FINRA is not the designated options examining authority (DOEA) for that firm.² The exemption reflected the fact that FINRA's regulatory responsibilities with respect to such activity were reassigned to another self-regulatory organization (SRO) through FINRA's participation in a plan under Rule 17d-2 of the Securities Exchange Act of 1934³ (17d-2 Agreement). Under the 17d-2 Agreement, regulatory responsibilities for certain FINRA firms that conducted a public options business were assumed by other SROs that would act as the firm's DOEA.⁴ Subsequent amendments to the 17d-2 Agreement have consolidated within FINRA sole regulatory responsibility for the public options activities of all of its firms.⁵ Consequently, FINRA now assumes all regulatory responsibility for FINRA firms under the 17d-2 Agreement, and effective November 1, 2010, FINRA is eliminating the exemption from the TAF for transactions in exchange-listed options when FINRA is not the DOEA for the firm.⁶

Trading Activity Fee FAQ

FINRA is publishing the TAF FAQ to provide additional guidance to firms regarding the TAF. Over the years, FINRA has published numerous *Notices* on the TAF, many of which include a list of questions and answers, in an effort to clarify calculation of the TAF and to help firms develop and monitor their processes around TAF payments.⁷ FINRA is publishing the TAF FAQ on its website to consolidate, and in some cases to update, the guidance previously published and to add additional questions and answers that firms have asked. The TAF FAQ addresses several topics, including general questions about how the TAF is assessed and calculated as well as specific questions on assessing the TAF on transactions in equity securities, debt securities, options and security futures. **The TAF FAQ supersedes any previous guidance published in the various *Notices*.**

The TAF FAQ can be found on FINRA's website at www.finra.org/taf/faq. Firms should review the FAQ and check the website periodically for updates to ensure that their processes and procedures for calculating the TAF are up to date and accurate. New questions will be marked "new," and previously published questions will be marked "updated" when they are updated or revised.

Firms are encouraged to contact FINRA at the numbers listed above to suggest additional topics or questions for inclusion in the TAF FAQ.

Endnotes

- 1 See Securities Exchange Act Release No. 63196 (October 27, 2010).
- 2 See Securities Exchange Act Release No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003). Transactions in over-the-counter (“conventional”) options are exempted from the TAF with respect to all FINRA members. See FINRA By-Laws, Schedule A, § 1(b)(2)(H).
- 3 17 CFR 240.17d-2.
- 4 See Securities Exchange Act Release No. 46800 (November 8, 2002), 67 FR 69774 (November 19, 2002).
- 5 See Securities Exchange Act Release No. 57987 (June 18, 2008), 73 FR 36156 (June 25, 2008).
- 6 Following the consolidation of NASD and NYSE member regulation operations in 2007, FINRA announced that it serves as the DOEA for all FINRA member firms. See *Regulatory Notice 08-37* (July 2008). FINRA had previously published a list of firms that had a DOEA other than FINRA. See *NTM 05-03* (January 2005).
- 7 See, e.g., *NTM 06-37* (August 2006); *NTM 05-23* (March 2005); *NTM 03-30* (June 2003); *NTM 02-75* (November 2002); *NTM 02-63* (September 2002)

Election Notice

Small Firm Advisory Board

Notice of SFAB Election and Ballots

Executive Summary

The purpose of this *Notice* is to distribute to eligible FINRA small firm members¹ the ballot to elect the New York Region member of the Small Firm Advisory Board (SFAB).

FINRA small firms in the New York Region as of the close of business on October 20, 2010, are eligible to vote for one of the candidates. Firms are urged to vote in the election of SFAB members.

Ballots are due by Friday, November 19, 2010, and the newly elected SFAB member will take office in January 2011. Attachment A lists the candidates certified by the Corporate Secretary of FINRA as satisfying requirements for the regional SFAB seat. Information about each candidate is available at www.finra.org/sfab/candidateprofiles.

Questions regarding this *Election Notice* may be directed to:

- Marcia E. Asquith, Senior Vice President and Corporate Secretary, at (202) 728-8949;
- T. Grant Callery, Executive Vice President and General Counsel (Corporate), at (202) 728-8285; or
- Chip Jones, Senior Vice President, Member Relations, at (240) 386-4797.

SFAB Election

Composition of the FINRA Small Firm Advisory Board

The SFAB comprises ten members, as follows:

- five regional members elected by small firms in the five FINRA regions (one from each region); and
- five at-large members appointed by FINRA.

October 21, 2010

Suggested Routing

- Executive Representatives
- Senior Management

Additionally, the Small Firm Governors² of the FINRA Board serve as ex-officio members of the SFAB.

The five regional members represent the following geographic regions:

- ▶ **Midwest Region:** Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota and Wisconsin (Districts 4 and 8)
- ▶ **New York Region:** New York (the counties of Nassau and Suffolk, and the five boroughs of New York City) (District 10)
- ▶ **North Region:** Connecticut, Delaware, the District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York (except for the counties of Nassau and Suffolk, and the five boroughs of New York City), Pennsylvania, Rhode Island, Vermont, Virginia and West Virginia (Districts 9 and 11)
- ▶ **South Region:** Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, the Canal Zone, Puerto Rico and the Virgin Islands (Districts 5, 6 and 7)
- ▶ **West Region:** Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming and the former U.S. Trust Territories (Districts 1, 2 and 3)

As mentioned above, the New York Region seat is currently up for election.

Candidate Eligibility

Any senior member of a small firm whose primary place of business and whose firm has its main office in the New York region (as indicated in FINRA records) was eligible to have his or her name placed on the ballot for this election. SFAB members must also continue to meet their qualifications for election at all times during their terms of office.

Attachment A lists the candidates certified by the Corporate Secretary of FINRA as satisfying requirements for each regional SFAB seat. Information about each candidate is available at www.finra.org/sfab/candidateprofiles.

Terms of SFAB Members

The successful candidate will be the individual who receives the most votes and will be elected to serve a three-year term.

The term of an SFAB member shall terminate immediately upon a determination by the SFAB, by a majority vote of the remaining members, that the member no longer satisfies the eligibility criteria. Additionally, the FINRA Board may remove from the SFAB a member who is unable or fails to discharge the member's duties or violates SFAB policies.

Once an individual has completed a full three-year, elected term on the SFAB, he or she is ineligible to run for re-election to the SFAB for another three years.³

Voting Eligibility

As mentioned above, FINRA small firms are eligible to vote for candidates running for the SFAB seat representing the region corresponding to the district to which they are assigned in the Central Registration Depository®.

Ballots have been mailed, along with a copy of this *Notice*, to the executive representatives of small firms in the New York region to elect the New York Region Representative. Firms may vote for only one candidate listed on the ballot.

Voting Methods

Firms will be able to vote by telephone, the Internet or U.S. mail. The ballot sent to eligible small firms contains detailed instructions on the submission procedures.

It is important that all eligible member firms vote. Ballots are due on Friday, November 19, 2010.

Endnotes

- 1 A small firm is defined as a member firm that employs at least one and no more than 150 registered persons. See Article I (ww) of the FINRA By-Laws.
- 2 A Small Firm Governor is defined as a member of the FINRA Board elected by small firm members. In order to be eligible to serve, a Small Firm Governor must be registered with a member that is a small firm and must be an Industry Governor. See Article I (xx) of the FINRA By-Laws.
- 3 The composition of the SFAB was revised in 2008, and in order to maintain continuity on the SFAB, three-year terms were phased in at that time. The individuals initially seated as the North Region and West Region SFAB Representatives were elected to two-year terms and the individuals initially seated as the Midwest and South SFAB Representatives were elected to one-year terms and therefore, were eligible for re-election. The incumbent New York region representative served a full three-year, elected term on the SFAB and is ineligible to run for re-election to the SFAB for another three years.

ATTACHMENT A

SFAB Candidates for the New York Region Seat

Steven Jafarzadeh	Stonehaven, LLC Chief Compliance Officer
David J. Laubach	Scarsdale Equities LLC Chief Compliance Officer
Miriam Lefkowitz	Shufro, Rose & Co., LLC General Counsel
Douglas Preston	Merrill Lynch Professional Clearing Corp. Senior Vice President, Compliance Executive
David V. Shields	Wellington Shields & Co., LLC Vice Chairman

Information Notice

Continuing Education Planning

Executive Summary

On October 15, 2010, the Securities Industry/Regulatory Council on Continuing Education (the Council) released the semi-annual Firm Element Advisory (FEA) (see *Regulatory Notice 10-50*). The Council suggests that firms consult the FEA when developing their Firm Element training needs analysis.

FINRA offers the following online training resources that address many of the topics that the Council has outlined in the FEA:

- **E-Learning Courses:** Online training featuring assessment tests, scenarios, real-time completion tracking and certificates of completion (see www.finra.org/elearning).
- **Podcasts:** Short audio recordings on specific targeted topics, which can be heard online or downloaded to a portable media player (see www.finra.org/podcasts).

Send questions regarding this *Notice* to education@finra.org.

FIRM ELEMENT ADVISORY TOPIC	FINRA OFFERINGS
FINRA Consolidated Rulebook	Rulebook Consolidation Podcast Series
Alternative Investments	Exchange-Traded Funds <ul style="list-style-type: none">• Non-Traditional Exchange-Traded Funds (Podcast)
	Principal-Protected Notes <ul style="list-style-type: none">• Principal-Protected Notes (Podcast)• Structured Products (E-Learning)
	Reverse Exchangeable Securities (Reverse Convertibles) <ul style="list-style-type: none">• Reverse Convertibles (Podcast)

October 15, 2010

Compliance

- Continuing Education
- Legal
- Training

Key Topics

- Continuing Education
- Firm Element

Referenced Rules & Notices

- Notice 10-50

FIRM ELEMENT ADVISORY TOPIC	FINRA OFFERINGS
Anti-Money Laundering	<p>For Staff Working With Retail Customers:</p> <ul style="list-style-type: none"> • AML—Retail: Customer Identification Procedures (E-Learning) • AML—Retail: Exploring New Risks (E-Learning) • AML—Retail: Recognizing and Escalating Suspicious Activity (E-Learning) • AML—Retail: Recognizing Red Flags (E-Learning) • AML—Retail: The Responsibility to Know Your Customer (E-Learning) • AML—Retail: Variable Annuities and Variable Life Insurance (E-Learning) <hr/> <p>For Staff Working With Institutional Customers:</p> <ul style="list-style-type: none"> • AML—Institutional: Customer Identification Procedures (E-Learning) • AML—Institutional: Escalating Concerns of Unusual Activity and Responsibilities for Due Diligence (E-Learning) • AML—Institutional: Exploring New Risks (E-Learning) • AML—Institutional: Identification and Reporting Issues (E-Learning) • AML—Institutional: Identifying and Managing Higher-Risk Clients (E-Learning) • AML—Institutional: Recognizing Red Flags (E-Learning) <hr/> <p>For Operations Staff:</p> <ul style="list-style-type: none"> • AML—Operations: Customer Identification Procedures (E-Learning) • AML—Operations: Escalating Concerns of Unusual Activity and Responsibilities for Due Diligence (E-Learning) • AML—Operations: Recognizing Red Flags (E-Learning) <hr/> <p>For Compliance Staff:</p> <ul style="list-style-type: none"> • AML Law Enforcement Requests (Podcast) • Anti-Money Laundering Template Podcast Series
Business Continuity	<ul style="list-style-type: none"> • Business Continuity Planning: Recent Survey Findings (Podcast) • FINRA’s Business Continuity Planning Template (Podcast) • Pandemic Preparedness – Parts I & II (Podcast)
Communications With the Public	<ul style="list-style-type: none"> • Communications With the Public: An Introduction to Compliance Issues (E-Learning) • Principal Approval of Sales Material (Podcast) • Seniors: Communications (Podcast)

FIRM ELEMENT ADVISORY TOPIC	FINRA OFFERINGS
Communications With the Public	<p>Blogs and Social Networking</p> <ul style="list-style-type: none"> • Electronic Communications: Blogs, Bulletin Boards and Chat Rooms (Podcast) • Electronic Communications: Social Networking Web Sites (Podcast) • Electronic Communications: Web Sites (Podcast) • Use of Social Media for Business Purposes (E-Learning)
Corporate Finance and Institutional Business	<p>Conflicts of Interest</p> <ul style="list-style-type: none"> • Conflicts of Interest (E-Learning) • Conflicts of Interest in Public Offerings (Podcast) <hr/> <p>Ethics</p> <ul style="list-style-type: none"> • Ethical Considerations for Institutional Operations Professionals (E-Learning) • Ethical Considerations for Institutional Registered Representatives (E-Learning) • Ethical Considerations for Institutional Sales Representatives (E-Learning) <hr/> <p>Member Private Offerings</p> <ul style="list-style-type: none"> • Private Placements (E-Learning) <hr/> <p>Resales of Unregistered Restricted Securities</p> <ul style="list-style-type: none"> • Unregistered Resales of Restricted Securities (Podcast)
Customer Accounts	<p>Consolidated Account Reports</p> <ul style="list-style-type: none"> • Consolidated Account Reports (Podcast) <hr/> <p>Customer Account Transfers</p> <ul style="list-style-type: none"> • Report of the Customer Account Transfer Taskforce (Podcast) • Suitability Issues: Considerations for Product Exchanges (E-Learning) • Variable Annuities: Sales Practice Issues for 1035 Exchanges (E-Learning) <hr/> <p>Customer Information Security</p> <ul style="list-style-type: none"> • Customer Information Protection for Registered Representatives (E-Learning) • Customer Information Protection for Supervisors (E-Learning)

FIRM ELEMENT ADVISORY TOPIC	FINRA OFFERINGS
Customer Accounts	<p>Requirements for Customer Assets</p> <ul style="list-style-type: none"> • Requirements for Customer Assets (Podcast) <hr/> <p>Trading Ahead of Customer Limit Orders</p> <ul style="list-style-type: none"> • Life of an Equity Trade (E-Learning)
Finance and Operations	<p>Recordkeeping Requirements</p> <ul style="list-style-type: none"> • Books and Records (E-Learning) • Record Retention Relief (Podcast)
Registration and Disclosure	<p>Revised Forms U4 and U5</p> <ul style="list-style-type: none"> • What to Expect: The U4 and U5 Filing Process (Podcast) • Uniform Forms Electronic Filing Requirements (Podcast) <hr/> <p>Continuing Membership Application</p> <ul style="list-style-type: none"> • Continuing Membership Application Series (Podcast)
Insurance and Annuities	<p>Deferred Variable Annuities</p> <ul style="list-style-type: none"> • AML—Retail: Variable Annuities and Variable Life Insurance (E-Learning) • Deferred Variable Annuities (Podcast) • Variable Annuities: Sales Practice Issues for 1035 Exchanges (E-Learning) • Variable Annuities: Suitability and Disclosure for New Purchases (E-Learning) • Variable Annuities: Requirements for Representatives (E-Learning) • Variable Annuities: Requirements for Supervisors (E-Learning) <hr/> <p>Variable Life Settlements</p> <ul style="list-style-type: none"> • AML—Retail: Variable Annuities and Variable Life Insurance (E-Learning) • Variable Life Settlements and Transactions in Related Investment Products—Your Firm's Obligations—Part I & II (Podcast)
Municipal Securities	<ul style="list-style-type: none"> • Debt Mark-Ups (E-Learning) • MSRB Supervision Rules (E-Learning) • Municipal Securities Podcast Series

FIRM ELEMENT ADVISORY TOPIC	FINRA OFFERINGS
Research	<p>Trading Ahead of Research Reports</p> <ul style="list-style-type: none"> • Trading Ahead of Research Reports (Podcast)
Sales Practices and Supervision	<ul style="list-style-type: none"> • Business Gifts: Understanding Supervisory Responsibilities (E-Learning) • Retail Branch Office Supervision: Compliance With Regulations (E-Learning) • Retail Branch Office Supervision: Understanding Supervisory Responsibilities (E-Learning) • Retail Supervision: Sales to Senior Investors (E-Learning) • Supervision: Obligations for Firms With Institutional Clients (E-Learning) • Supervision of Recommendations After a Registered Representative Changes Firms (Podcast) • Supervisory Considerations for Working with Seniors (E-Learning) • Sales Practices for Cash Alternatives (Podcast) • Unauthorized Proprietary Trading (Podcast) • Understanding Supervisory Controls (Podcast) • 529 College Savings Plan Sales Practices (E-Learning) • Regulatory and Business Considerations Series (Podcasts)
Trading Practices and Supervision	<ul style="list-style-type: none"> • Insider Trading (E-Learning) • Mutual Fund Sales Practice (E-Learning) • Penny Stock Sales (E-Learning)
Transaction Reporting and Data Dissemination	<ul style="list-style-type: none"> • Life of an Equity Trade (E-Learning)

Information Notice

Extension of Current Rate for Fees Paid Under Section 31 of the Exchange Act

Executive Summary

Since October 1, 2010, the SEC has been operating under a continuing resolution for fiscal year 2011. As such, the Section 31 rate applicable to securities transactions will remain at \$16.90 per million.

- ▶ **Finance-related questions should be directed to:** Sheila Gregory, Accounting Manager, Finance, at (240) 386-5388.
- ▶ **Legal and interpretive questions should be directed to:** Kathleen O'Mara, Associate General Counsel, Office of Oversight Liaison and Counsel, at (240) 386-5309.

Background and Discussion

As announced by the Securities and Exchange Commission (SEC) in Fee Rate Advisory #2 for Fiscal Year (FY) 2011, the SEC has been operating under a continuing resolution since the start of FY 2011 on October 1, 2010. The Fee Rate Advisory specifies that the fee paid under Section 31 of the Securities Exchange Act of 1934 (Exchange Act) will remain at the current rate of \$16.90 per million.

However, as the SEC has announced, 30 days after the date of enactment of its regular fiscal year 2011 appropriation, the rate for the Section 31 fee will increase from \$16.90 per million to \$19.20 per million. FINRA will notify firms through an Information Notice when the SEC's regular appropriation has been enacted and a final date has been determined for implementing the rate change to \$19.20 per million.

October 8, 2010

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Trading

Key Topic

- ▶ Section 31 Fee

Referenced Rules & Notices

- ▶ Section 3 of Schedule A to the By-Laws
- ▶ Section 31 of the Securities Exchange Act of 1934

FINRA obtains its Section 31 fees from member firms, in accordance with Section 3 of Schedule A to the By-Laws. Section 3 specifies that the amount assessed on firms will be determined periodically in accordance with Section 31 of the Exchange Act.

A copy of the SEC's October 1, 2010, order regarding fee rates for FY 2011 is available at www.sec.gov/rules/other/2010/33-9122.pdf.