

# Notices

## Regulatory Notices

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## eFOCUS Reporting

### eFOCUS System Updates Applicable to Joint Broker-Dealers/Futures Commission Merchants

**Effective Date: Monthly FOCUS Report Part II and Part II CSE Due on February 26, 2014, Covering the January 31, 2014, Reporting Period**

#### Executive Summary

Beginning with the monthly FOCUS Report that is due on February 26, 2014 (covering the January 31, 2014, reporting period), FINRA is updating specified reporting schedules under the eFOCUS system to incorporate several of the new financial reporting requirements the Commodity Futures Trading Commission (CFTC) has adopted. Each member firm that is a futures commission merchant (FCM) must file the updated schedules as part of its monthly FOCUS Reports. The modified version of the [FOCUS Report Part II and Part II CSE](#), which will include the updated CFTC schedules, will be available through FINRA's eFOCUS system beginning Monday, February 10, 2014.

Questions regarding this *Notice* should be directed to:

- ▶ Yui Chan, Managing Director, Risk Oversight & Operational Regulation (ROOR), at (646) 315-8426; or
- ▶ Susan DeMando Scott, Associate Vice President, ROOR, at (240) 386-4620.

#### Background & Discussion

In November 2013, the CFTC adopted amendments<sup>1</sup> to the CFTC's Regulation 1.10 that, among other things, include requirements for FCMs to make specified disclosures under the following schedules in the CFTC's Form 1-FR-FCM:<sup>2</sup>

- ▶ Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges (the "Segregation Schedule");

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##### Notice Type

- ▶ Guidance

##### Suggested Routing

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

##### Key Topics

- ▶ eFOCUS Reporting

##### Referenced Rules & Notices

- ▶ CFTC Regulation 1.10
- ▶ FINRA Rule 4521
- ▶ Regulatory Notice 10-46
- ▶ SEA Rule 17a-5

- ▶ Statement of Secured Amounts and Funds Held in Separate Accounts Pursuant to Commission Regulation 30.7 (the “Secured Amount Schedule”); and
- ▶ Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts Under Section 4d(f) of the Commodity Exchange Act (the “Cleared Swaps Segregation Schedule”).

The amendments to the Segregation Schedule and the Secured Amounts Schedule require each FCM to disclose the targeted amount of “residual interest”<sup>3</sup> that the FCM seeks to maintain in customer segregated accounts and secured accounts as computed under CFTC regulations. The Cleared Swaps Segregation Schedule is the new schedule that the CFTC has adopted<sup>4</sup> to further implement the cleared swaps segregation requirements set forth under Section 724(a) of the Dodd-Frank Act.<sup>5</sup> FINRA notes that the new Cleared Swaps Segregation Schedule replaces the Statement of Sequestration Requirements and Funds in Cleared OTC Derivatives Sequestered Accounts as implemented pursuant to [Regulatory Notice 10-46](#).

Pursuant to FINRA Rule 4521(a), FINRA member firms that are FCMs must file the updated schedules in eFOCUS as set forth in the modified FOCUS Report Part II and Part II CSE, commencing with the monthly FOCUS Report Part II and Part II CSE that is due on February 26, 2014 (covering the January 31, 2014, reporting period). The modified version of the [FOCUS Report Part II and Part II CSE](#), which will include the updated CFTC schedules, will be available through FINRA’s eFOCUS system beginning Monday, February 10, 2014.<sup>6</sup>

## Endnotes

1. See CFTC Final Rule Release, *Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations*, 78 FR 68506 (November 14, 2013).
2. CFTC Regulation 1.10 addresses the financial reporting requirements of FCMs and introducing brokers subject to the CFTC's jurisdiction. Form 1-FR-FCM is the CFTC's financial reporting form for FCMs under Regulation 1.10.
3. As stated by the CFTC, "residual interest" refers to a cushion of proprietary funds that an FCM deposits into customer segregated and secured accounts to protect against becoming undersegregated or undersecured by failing to hold a sufficient amount of funds in such accounts to meet regulatory requirements. See 78 FR at 68513.
4. See 78 FR at 68514. The CFTC stated that FCMs currently prepare a schedule comparable to the Cleared Swaps Segregation Schedule under applicable contract market or National Futures Association rules, and that the new schedule codifies existing practices. In this regard, FINRA implemented the Statement of Sequestration Requirements and Funds in Cleared OTC Derivatives Sequestered Accounts as announced in *Regulatory Notice 10-46* (October 2010).
5. Pub. L. No. 111-203, 124 Stat. 1376 (2010).
6. The CFTC's amendments include specified revisions to the Statement of Financial Condition under Form 1-FR-FCM. See 78 FR at 68515. Member firms should note that FINRA is not adopting these revisions into the Statement of Financial Condition under eFOCUS.

## Comprehensive Automated Risk Data System

### FINRA Requests Comment on a Concept Proposal to Develop the Comprehensive Automated Risk Data System

Comment Period Expires: February 21, 2014

#### Executive Summary

FINRA is requesting comment on a concept proposal to develop a new Comprehensive Automated Risk Data System (CARDS), a rule-based program that would allow FINRA to collect on a standardized, automated and regular basis, account information, as well as account activity and security identification information that a firm maintains as part of its books and records. This *Notice* is intended to obtain the views of firms and others at the initial stage of determining how FINRA should obtain broader information to advance its supervision of firms and their associated persons.

Questions concerning this *Notice* should be directed to:

- ▶ Daniel M. Sibears, Executive Vice President, Regulatory Operations/Shared Services, at (202) 728-6911;
- ▶ Jonathan Sokobin, Sr. Vice President, Office of the Chief Economist, at (202) 728-8248; or
- ▶ Victoria L. Crane, Associate General Counsel, Office of General Counsel, at (202) 728-8104.

December 2013

#### Notice Type

- ▶ Request for Comment

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Risk
- ▶ Senior Management
- ▶ Technology

#### Key Topics

- ▶ Reporting Requirements

#### Referenced Rules & Notices

- ▶ FINRA Rule 2111
- ▶ FINRA Rule 8210
- ▶ NASD Rule 3150
- ▶ NTM 03-73

## Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by February 21, 2014.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to [pubcom@finra.org](mailto: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

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

**Important Notes:** All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.<sup>1</sup>

## Background and Discussion

Technology is changing the way that FINRA examines firms and oversees the markets, by enabling FINRA to collect, process and analyze large quantities of information. Access to this information allows FINRA to analyze data in new ways that better protect investors and ensure market integrity. FINRA must take advantage of technological advancements to continue as an efficient and effective regulator.

As discussed in more detail below, CARDS is a broad ranging initiative supporting a comprehensive approach to supervising firms. Initially, FINRA envisions using CARDS to collect specific retail customer information—*i.e.*, information contained in required books and records—from clearing and self-clearing firms on a regular schedule. Introducing firms would be required to provide their clearing firms with specified information they control so that clearing firms can provide this information to FINRA in conjunction with other information the clearing firm provides. FINRA would use the information to run analytics that identify potential red flags of sales practice misconduct (*e.g.*, churning, excessive commissions, pump and dump schemes, markups, mutual fund switching), as well as help FINRA identify potential business conduct problems with member firms, branches and registered representatives.

In developing the CARDS concept, FINRA has begun to meet with industry participants and wishes to confer further with a broad cross-section of firms to identify a cost effective approach for submitting information from firm books and records. The information selected for submission to FINRA during the initial phase of CARDS would generally represent the same types of information FINRA currently collects on a firm-by-firm basis during the examination process. Based on experience with two major clearing firms with which FINRA tested the feasibility of an automated data acquisition program, FINRA believes that the vast majority of the information that CARDS would collect is already stored in an automated format at clearing and self-clearing firms and service bureaus. FINRA recognizes that the ability of firms to collect and submit the information efficiently in a standardized format may vary. As a result, FINRA envisions implementing CARDS through a phased approach over a reasonable period of time and is seeking comment regarding the structure of a phased approach.

#### **A. Current Information Collection**

FINRA's current risk-based national examination program is central to FINRA's efforts to protect investors. At its core, this examination program seeks to target potential business conduct abuses investors face. Currently, FINRA's examination program is a risk-based on-site approach that requires information collection for each examination on a firm-by-firm basis. FINRA collects firm data, such as purchase and sales blotters and customer account information, on an episodic basis.<sup>2</sup> These information requests necessarily vary in content, scope and time period, and may overlap if FINRA issues more than one request to the same firm for different events (such as a simultaneous financial and operational or market regulation examination). Because firms do not regularly produce the information FINRA collects for individual sales practice examinations, FINRA does not have a data-based method of assessing business conduct patterns and trends across the industry. In addition, for individual examinations, firms need time to provide the information requested while an examination is in progress. Such situations reduce FINRA's ability to assess the risk areas on which to focus its examination program, as well as FINRA's ability to efficiently review individual firm activities prior to an examination. CARDS would support the use of advanced technologies, defined data and targeted analytics that would permit FINRA to appropriately focus examinations on problematic areas.

Currently, FINRA information requests often require firms to produce information they maintain in multiple systems, requiring significant effort on the part of firms to comply. When FINRA is concerned about an investor protection threat, it may request information to be produced quickly, which increases the costs of the production. To respond to information requests, firms have indicated that they often must divert critical staff from their primary responsibilities, hire temporary staff, outsource the fulfillment effort to a third party or request special support from clearing firms. Though currently necessary to fulfill FINRA's responsibilities, individual information requests increase costs to firms, disrupt firms' business activities and slow FINRA examinations and inquiries.

## **B. Proposal for Automated Submission of Account Information Requested by FINRA**

Innovations in information technology now allow the collection, processing and analysis of large quantities of information. CARDS is designed to use this technology to support a more effective examination program.

CARDS' first phase is intended to increase FINRA's ability to use automated analytics on current and historical firm data to identify problematic sales practice activity. CARDS would enable FINRA to more efficiently review firm and industry activity and better focus its resources on key risks and exposures. Access to more comprehensive data would allow FINRA to better analyze customer dealing information on an individual firm basis, compare one firm's customer dealing activities against its peers', and understand industry-wide patterns and trends.

In addition, CARDS is intended to reduce burdens on firms by eliminating intermittent information requests from FINRA for the information CARDS covers. FINRA would also analyze CARDS information before examining firms on-site, thereby potentially reducing the length of examiners' on-site visits to firms.

To help inform this concept proposal, FINRA conducted two proofs of concept. One proof of concept collected information from individual firms to validate automated analytics designed to identify potentially problematic sales practice activities.<sup>3</sup> The other proof of concept collected information from two clearing firms to test the feasibility of an automated data acquisition program.<sup>4</sup>

These proofs of concept helped FINRA develop a new approach using automated analytics and an ongoing data acquisition program where information is regularly submitted by firms. FINRA applied analytics to individual firm data to identify potential red flags early in its examination preparation. Importantly, FINRA also developed a standard electronic data acquisition process that collected account, transactional and position data from two clearing firms on a recurring delivery schedule. By running the firm data through analytics for pattern detection, FINRA was able to more accurately identify risk areas. For example, the analytics showed FINRA that a firm was selling a new, high-risk product—a business in which the firm was not historically engaged and its financial reporting did not disclose. FINRA used information from another firm to identify suspicious pump and dump activity from several years prior to a clearing firm conversion.<sup>5</sup>

While these proofs of concept have been informative, firm input is critical to further explore the opportunities and issues of collecting and analyzing customer dealing data on an ongoing basis. Thus, FINRA encourages comments generally on the concept proposal as well as in response to the specific questions set forth in the Request for Comments section below. In particular, FINRA requests comment on the economic impact of CARDS, including the costs and benefits of the proposal, and requests submission of data and quantified comments, where possible.

### C. Data Specifications

As currently envisioned, once CARDS is implemented, clearing firms (on behalf of introducing firms) and self-clearing firms would submit in an automated, standardized format specific information relating to their customers' accounts and the customer accounts of each firm for which they clear. Such information would include, at a minimum:<sup>6</sup>

- ▶ **Account Information:** This information identifies account types associated with account activity, firms and their branches and associated persons responsible for supervision and sales. This information would be used for sales practice reviews such as quantitative suitability, commissions and markup/down, and penny stock activities.
  - ▶ Account types and categories (*e.g.*, retirement, brokerage, cash, margin, options, discretionary, day trading)
  - ▶ Customer investment profile information (*e.g.*, investment objective, date of birth)
  - ▶ An identifier for beneficial owners or control persons<sup>7</sup>
  - ▶ Servicing registered persons and locations (*e.g.*, registered person CRD number and branch CRD number)
- ▶ **Account Activity Information:** In conjunction with account information, account activity information serves as the primary basis for risk identification related to suitability reviews, fraud detection, anti-money laundering and other sales practice-related reviews.
  - ▶ Details of account activity (*e.g.*, purchases and sales transactions, event dates)
  - ▶ Additions/withdrawals, securities and account transfers
  - ▶ Margin and balances
- ▶ **Security Identification Information:** Security identification information is required for FINRA to determine the characteristics of securities.
  - ▶ Description of securities (*e.g.*, CUSIP, symbol, description, name, ISIN, SEDOL)

Introducing firms would not be required to transmit the specified information directly to FINRA, but would provide their clearing firms with information in their possession that is necessary for the clearing firms to comply with CARDS' information submission requirements. Clearing firms would not be responsible for ensuring the accuracy or completeness of the information provided to them by their introducing firms for submission to FINRA in compliance with the program. The initial phase of CARDS would focus on information that is already required to be created and maintained by either the clearing firm or the introducing firm.

Any clearing or self-clearing firm submitting information would submit such information in a manner that would enable FINRA to distinguish between information pertaining to customer accounts of an introducing firm and information pertaining to customer accounts of any firm for which the introducing firm is acting as an intermediary in obtaining clearing services from a clearing or self-clearing firm.

FINRA envisions that firms would submit the required information to FINRA on a regular schedule (such as daily or weekly) in a standardized format that would permit FINRA to run analytics for a particular day during the period being reported. A firm submitting information would be permitted to enter into an agreement with a third party to fulfill the firm's reporting obligations. However, notwithstanding the existence of such an agreement, each firm would remain responsible for complying with the information reporting requirements.<sup>8</sup>

Given the value and sensitivity of the information to be collected via CARDS, it is essential that this information is protected from unauthorized disclosure or use. CARDS would incorporate current and effective information security methods to protect this information. FINRA welcomes comments regarding ways to further reduce security risks.

FINRA requests comment generally on the data specifications described in this *Notice*, as well as in response to the specific questions in the Request for Comments section below.

#### **D. Phased Implementation Approach**

As currently envisioned, the first phase of CARDS would focus on business conduct for retail accounts, but FINRA is considering ways to further structure such an approach. For example, FINRA is considering whether the initial phase of CARDS should begin with a select group of firms and the collection of a subset of information.

Based on information received in response to this *Notice*, FINRA would consider whether to include additional phases in implementing CARDS, and how to expand CARDS during any such later phases of its implementation.

#### **E. Economic Impact**

CARDS would require the submission to FINRA of account information, as well as account activity and security identification information by clearing firms (on behalf of introducing firms) and self-clearing firms. Introducing firms typically collect and retain information about the customer, including account information. Introducing firms may also have in their possession limited account activity and security identification information.

FINRA understands that, currently, clearing firms' systems may collect and retain information for new accounts of their introducing firms, and create and retain account activity and security identification information for such firms. Clearing firms' systems differ in how they collect and store this information and may or may not have unused or open fields in their systems. As a result, clearing firms have in their systems some but not all the information that would be required by CARDS.

### 1. *Anticipated Benefits of the Proposal*

As discussed in more detail above, CARDS would be expected to reduce present regulatory costs and burdens on firms by reducing the need for manual, partial, overlapping and one-time regulatory report generation for the information required to be reported to CARDS. It would result in a standard technology interface that would enable firms and FINRA to create and maintain one set of computer programs for firms to submit and FINRA to collect the information required by CARDS.

CARDS is intended to increase the effectiveness of the examination process by enabling FINRA to identify risks to efficiently target firm surveillance and examination programs. While FINRA has improved its approach over recent years to better gather firm information, standardized information collection and automated analytics would greatly strengthen that process.<sup>9</sup> In addition, following FINRA's analyses of the information firms provide, FINRA could share its analyses, including performance benchmarks, with firms to help firms with their compliance and supervisory programs.

CARDS would not supplant the legal, compliance and supervisory programs firms administer. Rather, a firm's compliance and supervisory programs would continue to have the obligation to conduct oversight to prevent and detect problems based on the full information firms hold.

CARDS would also reduce FINRA's reliance upon, and eventually replace the use of, existing data systems and feeds, such as INSITE.<sup>10</sup> FINRA is committed to a thorough analysis of existing as well as any future reporting requirements, such as those that may be required by the Consolidated Audit Trail (CAT), to eliminate duplication of reporting requirements as CARDS is implemented.

### 2. *Anticipated Costs of the Proposal*

Clearing firms would likely incur costs to build and maintain the infrastructure to submit the required information to FINRA. Clearing firms may also incur costs to monitor the information transmission. Introducing firms also would likely incur costs in providing additional information to their clearing firms to meet the new requirements. Introducing firms may face additional costs if they currently use open fields in the clearing firms' systems for their own business but are unable to do so going forward due to CARDS' information submission requirements. Both introducing and clearing firms may have to develop new procedures around information transmission and resolution.

Firms would incur costs if CARDS requires historical data to be collected for account information that was not previously received by the clearing firm. The burden of the costs would depend on whether the obligation to update the information was the responsibility of the introducing or clearing firm.

The potential costs may be affected by the frequency of the information transfers, whether the transfers are for complete datasets or only the changes between periods, and how the clearing or introducing firms create and maintain their information presently. As set forth in the Request for Comments section below, FINRA requests comment on the distinct costs that clearing and introducing firms would incur.

### 3. *Other Economic Impacts*

Once CARDS is implemented, FINRA intends to conduct a public retrospective review following an appropriate period to determine whether it is effectively achieving its intended purpose.

## Request for Comments

FINRA seeks comments on the CARDS concept proposal, outlined above. In addition to general comments, FINRA specifically requests comments on the following questions. FINRA requests data and quantified comments where possible.

1. Are there alternative methods for FINRA to achieve its goals as articulated? If so, what are those alternatives and why might they be better suited? Are there other information collection methods FINRA should consider either as an alternative, or as a supplement, to CARDS?
2. What would be the primary sources of economic impact, including the potential costs and benefits, to clearing, self-clearing and introducing firms in developing, implementing and maintaining the systems that would be necessary to comply with the reporting requirements of CARDS? What systems would potentially have to be modified and what would be the anticipated costs? Would the primary sources of economic impact differ based on the size of the firm or differences in the business model?
3. In addition to systems modifications, what other potential changes to firms' infrastructure would be necessary? For example, would firms need to hire additional personnel either on a temporary or full-time basis to implement CARDS?
4. To what extent do firms believe that they would rely upon third parties to fulfill their reporting obligations? Should FINRA specify supervisory obligations for firms that enter into agreements with third parties to fulfill the firms' reporting requirements related to CARDS? How could FINRA use CARDS to reduce firm use of personnel or third parties to fulfill examination and reporting requirements?
5. To what extent do introducing firms currently maintain customer profile and suitability information with their clearing firms? If introducing firms maintain such information with the clearing firm, to what extent do introducing firms use the clearing firms' data fields in providing the information to the clearing firms? If the clearing firms' data fields are not used, how do introducing firms provide the information to their clearing firms? What would be the potential costs to introducing firms in providing the data elements required by CARDS to their clearing firms? If the data is not currently maintained in a standardized form, how much effort would be required to standardize the data to ensure comparability? Although CARDS contemplates the transmission of information from clearing firms to FINRA, would introducing firms find it more efficient and cost effective to transmit the specified information (or portions thereof) directly to FINRA?

6. The information provided to FINRA would include, at a minimum, account, account activity and security identification information. Is this information collected and maintained for all types of customers and products? To what extent is this information currently maintained in an automated format? To what extent is the information stored at clearing and self-clearing firms versus service bureaus?
7. FINRA expects that as applicable securities laws and FINRA rules evolve and are amended to include additional books and records requirements, it would revise CARDS' data specification elements to include that information. FINRA is contemplating assessing whether revisions to the data elements would be necessary on a 12- to 18-month cycle. What would be the feasibility of a 12- to 18-month cycle and what could impact that feasibility? What could be the potential economic impact of a 12- to 18-month revision cycle?
8. FINRA is considering submissions of the required information to FINRA on a regular schedule (such as weekly or daily) in a format that would permit FINRA to run analytics for a particular day during the period being reported. Should FINRA require a longer or shorter period of time for submission of the information to FINRA? Given the proposed purpose for collecting the information, what would be an appropriate schedule for submission of the information to FINRA? What would be the costs and benefits of a longer versus a shorter reporting schedule for submission of the information to FINRA? What would be the costs and benefits of requiring different submission schedules depending on the information to be provided to FINRA? For example, what would be the costs and benefits if FINRA were to require monthly submission of account information, but daily submission of account activity information?
9. FINRA is considering a phased approach to implementing CARDS. It envisions that the first phase of CARDS would focus on business conduct for retail accounts. What are the ways in which the first phase could be structured to best achieve the goal of focusing it on business conduct for retail accounts?
10. For purposes of the initial phase of CARDS, would firms be able to clearly distinguish between retail customers and others? What systems changes, if any, would be necessary to allow firms to limit the submission of information to retail account activity? What would be the economic impact on firms, including the costs and benefits of limiting the initial phase of CARDS to the submission of information relating to retail account activity only? Is it easier or harder to limit reporting to retail account activity? What other types of account activity should or should not be included in an initial phase of implementation? How should historical information versus new accounts be treated under a phased approach?
11. Following FINRA's analyses of the datasets firms provide, would it be beneficial for firms to receive the data with performance benchmarks? If so, should FINRA make that data available directly or through vendors or clearing firms?

## 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 *Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
2. FINRA information requests are triggered by expected events such as cycle examinations (approximately 1,700 to 2,400 per year depending on cyclical demands) and other non-routine events such as cause examinations, enforcement investigations and special sweeps that often cover similar periods.
3. The proof of concept focused on the use of the Risk Analytic Development Tool (RDAT), an electronic data submission format tool. FINRA used the RDAT for 12 examinations in 2012. The RDAT proof of concept validated that the automated analytics contained in RDAT were successful in identifying potentially problematic sales practice activity in many of the examinations. In addition, the analytics were successful in providing a better understanding of the firm's business model, operations and sales activity, and improving the quality of business conduct reviews through comprehensive, automated analysis of all brokerage activity. However, the data acquisition process was burdensome on FINRA staff and member firms due to a lack of standardization and automation. As a result, it was not feasible to move to a broader implementation. Nonetheless, through the proof of concept, FINRA reviewed much larger data sets than through current examination techniques.
4. FINRA engaged in the second proof of concept in early 2013. The goals of this proof of concept were to validate the operational and regulatory concerns with delivering the data; assess the data quality and availability of the desired data elements at the clearing firms; validate the interfaces of the analytics tools used in the program; and develop the internal business concept of operations around usage of the data.  
  
To date, FINRA has successfully implemented an automated data acquisition program by collecting information for a total of 300 introducing firms from the participating clearing firms. In particular, FINRA identified the required data elements that these firms then extracted from their systems and transmitted to FINRA.
5. In August 2013, FINRA launched a pilot program that married RDAT with the information for the 300 introducing firms acquired from the clearing firms in the early 2013 proof of concept. The pilot includes 65 examinations, and involves examination teams from each FINRA district office. FINRA intends to continue collecting and analyzing information received as part of the pilot to better inform it about clearing firm information and capabilities and to assist it with articulating the data specifications for CARDS.
6. FINRA expects that as applicable securities laws and FINRA rules evolve and are amended to include additional books and records requirements, it would revise CARDS' data specification elements to include that information.
7. As FINRA develops CARDS, it intends to consider ways in which to gather account identifying information without disclosing account names or other personally identifiable information.

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8. FINRA notes that, in developing CARDS, it is not intending to amend FINRA's rules governing firm books and records requirements. *See, e.g.*, FINRA Rule 4511(b) (providing that member firms shall preserve for a period of at least six years those FINRA books and records for which there is no specified period under the FINRA rules or applicable Exchange Act rules).
9. For example, FINRA recently updated the FINRA Firm Gateway Records Request for cycle examinations and Information Request for other examinations (collectively "Records Requests") to facilitate the electronic request and fulfillment of electronic business documents. The Records Requests system includes a "Request Manager" that is a secure, encrypted channel for document requests and responses that also tracks the requested documents and allows firms to see the status of all requested documents on one screen.
10. INSITE, or "Integrated National Surveillance and Information Technology Enhancements," is an electronic information collection tool that gathers data pursuant to NASD Rule 3150 (Reporting Requirements for Clearing Firms) via technical specifications and requirements published on FINRA's website (*see* INSITE web page).

## New Issue Allocations and Distributions

### SEC Approves a Limited Exception From FINRA Rule 5131(b) to Permit Firms to Rely Upon a Written Representation From Certain Unaffiliated Private Funds

Effective Date: February 3, 2014

#### Executive Summary

The SEC approved amendments to Supplementary Material .02 (Written Representations) to FINRA Rule 5131 (New Issue Allocations and Distributions) to provide a limited exception to facilitate firm compliance when allocating shares of a new issue to the accounts of certain unaffiliated private funds.<sup>1</sup>

The text of the amendments can be found in the online FINRA Manual at [www.finra.org/finramanual](http://www.finra.org/finramanual).

Questions regarding this *Notice* should be directed to Racquel Russell, Associate General Counsel, Office of General Counsel, at (202) 728-8363.

#### Background and Discussion

FINRA Rule 5131 (New Issue Allocations and Distributions) addresses potential abuses in the allocation and distribution of “new issues.”<sup>2</sup> Rule 5131(b) addresses the practice of “spinning,” where a firm allocates shares of a new issue to the account of an executive officer or director of a public company<sup>3</sup> or a covered non-public company<sup>4</sup> (and materially supported persons)<sup>5</sup> as an award for retaining the firm for investment banking business.<sup>6</sup> The rule’s spinning prohibitions generally apply to allocations to executive officers and directors:

1. whose companies are current or recent (within the past 12 months) investment banking clients;
2. where the person responsible for making the allocation decision knows or has reason to know that the firm intends to provide or expects to be retained for investment banking services by the company within the next three months; or

#### December 2013

##### Notice Type

- ▶ Rule Amendment

##### Suggested Routing

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

##### Key Topics

- ▶ Allocations
- ▶ Conflicts of Interest
- ▶ Initial Public Offerings
- ▶ Investment Banking
- ▶ New Issues
- ▶ Public Offerings
- ▶ Spinning

##### Referenced Rules

- ▶ FINRA Rule 5130
- ▶ FINRA Rule 5131
- ▶ Investment Advisers Act Section 202

3. on condition that the executive officer or director, on behalf of the company, will retain the firm for the performance of future investment banking services.

Since the rule's inception, firms have been permitted to rely upon a written representation obtained within the prior 12 months from the beneficial owner of an account, or a person authorized to represent the beneficial owner, as to whether the beneficial owner is an executive officer or director (or materially supported person) and, if so, the name of the company on whose behalf the executive officer or director serves. FINRA believes that firms have found this provision useful in cases where the potentially covered person is a direct beneficial owner of the account that may receive the new issue allocation.

However, firms have raised concerns regarding the difficulty involved in obtaining, tracking and aggregating information from accounts regarding indirect beneficial owners, such as participants in a fund of funds, for use in determining an account's eligibility to receive a new issue allocation.<sup>7</sup> To address these concerns, FINRA has amended Rule 5131 to provide an exception, codified as Rule 5131.02(b) (Indirect Beneficial Owners), to ease compliance with the spinning provision in situations where the ability of an underwriter to confer any meaningful financial benefit to a particular investor by allocating new issue shares to the account is impracticable. Specifically, the new exception permits firms to rely upon a written representation obtained within the prior 12 months from a person authorized to represent an account that does not look through to the beneficial owners of any unaffiliated private fund invested in the account, except for beneficial owners that are control persons of the investment adviser to the private fund, that the unaffiliated private fund:

- ▶ is managed by an investment adviser;
- ▶ has assets greater than \$50 million;
- ▶ owns less than 25 percent of the account and is not a fund in which a single investor has a beneficial interest of 25 percent or more; and
- ▶ was not formed for the specific purpose of investing in the account.

Supplementary Material .02(b) further provides that an "unaffiliated private fund" is a "private fund," as defined in Section 202(a)(29) of the Investment Advisers Act,<sup>8</sup> whose investment adviser does not have a control person<sup>9</sup> in common with the investment adviser to the account. A control person of an investment adviser is a person with direct or indirect "control" over the investment adviser, as that term is defined in Form ADV.

As is currently the case, a firm may rely upon a written representation pursuant to Supplementary Material .02 unless it believes, or has reason to believe, that the representation is inaccurate, and must maintain a copy of all records and information relating to whether an account is eligible to receive an allocation of the new issue in its files for at least three years following the firm's allocation to that account.

Amended Rule 5131 becomes effective on February 3, 2014. For more information, see FINRA rule filing [SR-FINRA-2013-037](#).

## Endnotes

1. See Securities Exchange Act Release No. 70957 (November 27, 2013); 78 FR 72946 (December 4, 2013) (Order Approving SR-FINRA-2013-037).
2. Rule 5131 provides that “new issue” has the same meaning as in Rule 5130(i)(9), which generally includes any initial public offering of an “equity security,” as defined in Section 3(a)(11) of the Exchange Act, made pursuant to a registration statement or offering circular, with enumerated exceptions.
3. A “public company” is any company that is registered under Section 12 of the Exchange Act or files periodic reports pursuant to Section 15(d) thereof. See Rule 5131(e)(1).
4. The rule defines a “covered non-public company” as any non-public company satisfying the following criteria: (i) income of at least \$1 million in the last fiscal year or in two of the last three fiscal years and shareholders’ equity of at least \$15 million; (ii) shareholders’ equity of at least \$30 million and a two-year operating history; or (iii) total assets and total revenue of at least \$75 million in the latest fiscal year or in two of the last three fiscal years. See Rule 5131(e)(3).
5. “Material support” means directly or indirectly providing more than 25 percent of a person’s income in the prior calendar year. Persons living in the same household are deemed to be providing each other with material support. See Rule 5131(e)(6).
6. “Investment banking services” include, without limitation, acting as an underwriter, participating in a selling group in an offering for the issuer or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger, acquisition or other corporate reorganization; providing venture capital, equity lines of credit, private investment, public equity transactions (PIPEs) or similar investments or otherwise acting in furtherance of a private offering of the issuer; or serving as placement agent for the issuer. See Rule 5131(e)(5).
7. For example, firms have noted that broker-dealers normally do not know the identity of the beneficial owners of the fund of funds invested in the account.
8. Section 202(a)(29) of the Investment Advisers Act of 1940 defines the term “private fund” as an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3) (Investment Company Act), but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act.
9. A control person of an investment adviser is a person with direct or indirect “control” over the investment adviser, as that term is defined in Form ADV.

## Interpretations of SEC Rules

### FINRA Announces Updates of the Interpretations of Financial and Operational Rules

#### Executive Summary

FINRA is making available updates to the Interpretations of Financial and Operational Rules that the staff of the SEC's Division of Trading and Markets (SEC staff) have communicated to FINRA. The updated interpretations—consisting of specified additions, revisions and rescissions, as set forth in this *Notice*—relate to Securities Exchange Act (SEA) Rules 15c3-1, 15c3-1b, 15c3-1d, 15c3-3 and 17a-5.

Questions concerning this *Notice* should be directed to:

- ▶ Yui Chan, Managing Director, Risk Oversight and Operational Regulation (ROOR), at (646) 315-8426; or
- ▶ Susan DeMando Scott, Associate Vice President, ROOR, at (240) 386-4620.

#### Background & Discussion

SEC staff continues to communicate and issue written and oral interpretations of various SEC rules. FINRA previously published the Interpretations of Financial and Operational Rules on its website in [Regulatory Notice 08-56](#). As FINRA noted in the *Notice*, the interpretations, referred to as the Interpretations of Financial and Operational Rules, are imbedded in the text of relevant rules and immediately follow the section of the rule that they interpret. The interpretations also retain the original date of publication or issuance and, if applicable, any subsequent publication or issuance date(s).

The following sets forth the interpretation updates that are being made available. Page references refer to the hardcopy version. These interpretations are being updated with specified additions, revisions and rescissions and are available in portable digital format (pdf) FINRA's [Interpretations of Financial and Operational Rules](#) page.

December 2013

#### Notice Type

- ▶ Guidance

#### Suggested Routing

- ▶ Compliance
- ▶ Finance
- ▶ Legal
- ▶ Operations
- ▶ Regulatory Reporting
- ▶ Senior Management

#### Key Topics

- ▶ Books and Records
- ▶ Customer Protection
- ▶ Financial Reporting
- ▶ Net Capital

#### Referenced Rules & Notices

- ▶ Regulatory Notice 08-46
- ▶ Regulatory Notice 08-56
- ▶ SEA Rule 15c3-1
- ▶ SEA Rule 15c3-1b
- ▶ SEA Rule 15c3-1d
- ▶ SEA Rule 15c3-3
- ▶ SEA Rule 17a-5

New interpretations that have been **added**:

- ▶ SEA Rule 15c3-1(c)(1)/26 (Fines and Other Monetary Penalties Assessed by a Governmental Agency or Self-Regulatory Organization) on page 158. This interpretation provides guidance as to the treatment of such items as either contingent or actual liabilities.
- ▶ SEA Rule 15c3-1(c)(2)(iv)(C)/075 (Treatment of an Unsecured Receivable Due From a Guaranteed Subsidiary) on page 294. This interpretation replaces an interpretation that has been rescinded (*see* SEA Rule 15c3-1(c)(2)(iv)(C)/07 (Intercompany Accounts with Guaranteed Subsidiaries) on page 292 and “Interpretations that have been rescinded” section of this *Notice*) and clarifies the net capital treatment of a receivable from a guaranteed subsidiary.
- ▶ SEA Rule 15c3-1(c)(2)(iv)(C)/17 (Investment Advisory Fees) on page 301. This interpretation provides conditions for allowable asset treatment of investment advisory fees in the computation of net capital.
- ▶ SEA Rule 15c3-1(c)(2)(iv)(E)/0211 (Monetary Penalty Resulting From the Voluntary Termination of a Clearing Agreement) on page 321. This interpretation clarifies the net capital implications to introducing broker-dealers when a voluntary termination of their clearing agreement results in a monetary penalty owed to their clearing broker-dealer. This guidance was previously published in [Regulatory Notice 08-46](#).
- ▶ SEA Rule 15c3-1(c)(2)(iv)(E)/0212 (Clearing Agreements Containing a Termination Penalty Clause) on page 322. This interpretation addresses the net capital treatment of introducing firms’ clearing deposits held by their clearing broker-dealers when their clearing agreement contains a termination penalty clause and discusses the conditions that must be satisfied in order for the clearing deposit to be treated as an allowable asset in the computation of the introducing firm’s net capital. This guidance was previously published in [Regulatory Notice 08-46](#).
- ▶ SEA Rule 15c3-1(c)(2)(vi)(D)/03 (Redeemable Securities of an Investment Company Registered Under the Investment Company Act of 1940) on page 452. This interpretation outlines the conditions under which redeemable securities of an investment company registered under the Investment Company Act of 1940 would be subject to a haircut deduction of 15 percent.
- ▶ SEA Rule 15c3-1(c)(2)(vii)/001 (FOCUS Reporting of Non-Marketable Inventory Positions) on page 550. This interpretation clarifies the proper net capital treatment and reporting of non-marketable inventory positions on the FOCUS Report.

- ▶ SEA Rule 15c3-1d(a)(2)(iii)/031 (Haircut Deduction on Foreign Currency Contributed as Collateral to a Secured Demand Note) on page 1305. This interpretation replaces a rescinded interpretation (*see* SEA Rule 15c3-1d(a)(2)(iii)/03 (Foreign Currency) on page 1305 and “Interpretations that have been rescinded” section of this *Notice*) and provides clarification of the haircuts applicable to foreign currency collateralizing a secured demand note.
- ▶ SEA Rule 17a-5(a)(2)(i)/03 (Retroactive Application of Changes in Accounting Principles) on page 3202. This interpretation provides guidance about FOCUS report, net capital and other calculations filing requirements when a broker-dealer adopts a new accounting principle on a retroactive basis, as well as the proper FOCUS reporting of adjustments resulting from such changes.

Interpretations that have been **revised**:

- ▶ SEA Rule 15c3-1(c)(2)(iv)(E)/021 (Clearing Deposits of Introducing Brokers) on pages 320-321. This interpretation outlines updated requirements applicable to clearing deposits maintained at a clearing broker-dealer. This guidance was previously published in [Regulatory Notice 08-46](#).
- ▶ The following four interpretations have been revised to reflect updated titles, revisions to the list of major foreign currencies and other minor clarifications:
  - ▶ SEA Rule 15c3-1(c)(2)(vi)/08 (Haircut Deduction on a Foreign Currency Balance) on page 406.
  - ▶ SEA Rule 15c3-1(c)(2)(vi)/09 (Haircut Deductions on Inventory Positions Denominated in a Foreign Currency) on page 407.
  - ▶ SEA Rule 15c3-1b(a)(3)(ix)(C)/01 (Haircut Deduction on a Foreign Currency Balance) on page 1121.
  - ▶ SEA Rule 15c3-1b(a)(3)(ix)(E)/01 (Forward Contracts in Foreign Currency) on page 1122.
- ▶ SEA Rule 15c3-3(Exhibit A - Item 4)/04 (Continuous Net Settlement Balances (CNS) - Fails to Receive) on page 2692. This interpretation clarifies the proper reporting of CNS fails to receive balances in the reserve formula computations.
- ▶ SEA Rule 15c3-3(Exhibit A - Item 12)/03 (Continuous Net Settlement Balances (CNS) - Fails to Deliver) on page 2751. This interpretation clarifies the proper reporting of CNS fails to deliver balances in the reserve formula computations.

Interpretations that have been **rescinded**:

- ▶ SEA Rule 15c3-1(c)(2)(iv)(C)/07 (Intercompany Accounts with Guaranteed Subsidiaries) on page 292. This interpretation relating to the treatment of unsubordinated, unsecured amounts receivable from a guaranteed subsidiary has been replaced by a new interpretation (see SEA Rule 15c3-1(c)(2)(iv)(C)/075 (Treatment of an Unsecured Receivable Due From a Guaranteed Subsidiary) on page 294) (see “New interpretations that have been added” section of this *Notice*).
- ▶ SEA Rule 15c3-1(c)(2)(iv)(F)(3)(ii)/04 (Repurchase Transactions to Maturity) on page 355. This interpretation relating to haircuts on securities collateralizing repurchase transactions to maturity has been rescinded.
- ▶ SEA Rule 15c3-1d(a)(2)(iii)/03 (Foreign Currency) on page 1305. This interpretation relating to haircuts on a foreign currency collateralizing a secured demand note has been replaced with a new interpretation, SEA Rule 15c3-1d(a)(2)(iii)/031 (Haircut Deduction on Foreign Currency Contributed as Collateral to a Secured Demand Note) also on page 1305 (see “New interpretations that have been added” section of this *Notice*).

For FINRA member firms and others that maintain the hardcopy version of the Interpretations of Financial and Operational Rules, the accompanying [updated pages](#), containing the aforementioned interpretations, are being distributed as replacements for existing pages with the following filing instructions:

SEA Rule	Remove Old Pages	Add New Pages
15c3-1	158	158
15c3-1	292	292
15c3-1	294	294
15c3-1	300-323	300-323
15c3-1	355	355
15c3-1	406-408	406-408
15c3-1	452	452
15c3-1	532-551	532-551
15c3-1b	1121-1122	1121-1122
15c3-1d	1304	1304-1305
15c3-3	2692-2694	2692-2695
15c3-3	2744-2752	2744-2752
17a-5	3202-3206	3202-3206

## Rollovers to Individual Retirement Accounts

### FINRA Reminds Firms of Their Responsibilities Concerning IRA Rollovers

#### Summary

FINRA is issuing this *Notice* to remind firms of their responsibilities when (1) recommending a rollover or transfer of assets in an employer-sponsored retirement plan to an Individual Retirement Account (IRA) or (2) marketing IRAs and associated services. Reviewing firm practices in this area will be an examination priority for FINRA in 2014.

Questions concerning this *Notice* should be directed to:

- ▶ Thomas M. Selman, Executive Vice President, Regulatory Policy, at (202) 728-6977 or [tom.selman@finra.org](mailto:tom.selman@finra.org); or
- ▶ Angela C. Goelzer, Vice President, at (202) 728-8120 or [angela.goelzer@finra.org](mailto:angela.goelzer@finra.org).

#### Background and Discussion

Saving for retirement is a top financial concern for Americans and many are confused about their retirement savings options.<sup>1</sup> Because broker-dealers often advise customers regarding retirement plans, this *Notice* addresses these interactions. In particular, the *Notice* addresses firms' recommendations to participants in employer-sponsored 401(k) retirement plans who terminate their employment and must determine how to invest their plan assets.<sup>2</sup> FINRA reminds firms of their responsibilities when they recommend that such an investor roll over or transfer plan assets to an IRA.<sup>3</sup>

A plan participant leaving an employer typically has four options (and may engage in a combination of these options):

- ▶ leave the money in his former employer's plan, if permitted;
- ▶ roll over the assets to his new employer's plan, if one is available and rollovers are permitted;<sup>4</sup>
- ▶ roll over to an IRA; or
- ▶ cash out the account value.<sup>5</sup>

December 2013

#### Notice Type

- ▶ Guidance

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Registered Representatives
- ▶ Senior Management

#### Key Topics

- ▶ Communications with the Public
- ▶ 401(k) Plans
- ▶ Individual Retirement Accounts
- ▶ Suitability
- ▶ Supervision
- ▶ Training

#### Referenced Rules & Notices

- ▶ FINRA Rule 2010
- ▶ FINRA Rule 2111
- ▶ FINRA Rule 2210
- ▶ NASD Rule 3010
- ▶ NASD Rule 3012
- ▶ Regulatory Notice 13-23

Each choice offers advantages and disadvantages, depending on desired investment options and services, fees and expenses, withdrawal options, required minimum distributions, tax treatment, and the investor's unique financial needs and retirement plans. The complexity of these choices may lead an investor to seek assistance from a financial adviser, including a broker-dealer. Investors also may be solicited by financial services firms, including broker-dealers, regarding IRAs and retirement services.<sup>6</sup>

A broker-dealer's recommendation that an investor roll over retirement plan assets to an IRA typically involves securities recommendations subject to FINRA rules. A firm's marketing of its IRA services also is subject to FINRA rules.<sup>7</sup> Any recommendation to sell, purchase or hold securities must be suitable for the customer and the information that investors receive must be fair, balanced and not misleading.<sup>8</sup> This *Notice* provides guidance on these activities and is intended to help firms ensure that they have policies and procedures in place that are reasonably designed to achieve compliance with FINRA rules.

#### 1. IRAs in the U.S. Retirement Market

IRAs account for about 28 percent of all U.S. retirement assets, which totaled \$19.5 trillion at the end of 2012. Of this amount, IRA assets were \$5.4 trillion, compared with \$5.1 trillion in defined contribution plans and \$9 trillion in other retirement plans.<sup>9</sup> Approximately 98 percent of IRAs with \$25,000 or less are brokerage accounts.<sup>10</sup>

Rollovers from employer-sponsored retirement plans are the largest source of contributions to IRAs. A [June 2013 Employee Benefits Research Institute report](#) states that in 2011, assets rolled over into IRAs were almost 13 times the amount of direct contributions. This is not a new trend; ICI data indicates that from 1996 to 2008 more than 90 percent of funds flowing into traditional IRAs came from rollovers, primarily from plans.<sup>11</sup> In 2013, 49 percent of the traditional IRAs held by U.S. households included rollover funds.<sup>12</sup>

#### 2. The IRA Rollover Decision

A recommendation to roll over plan assets to an IRA rather than keeping assets in a previous employer's plan or rolling over to a new employer's plan should reflect consideration of various factors, the importance of which will depend on an investor's individual needs and circumstances. Some of the factors include:

- ▶ **Investment Options**—An IRA often enables an investor to select from a broader range of investment options than a plan.<sup>13</sup> The importance of this factor will depend in part on how satisfied the investor is with the options available under the plan under consideration. For example, an investor who is satisfied by the low-cost institutional funds available in some plans may not regard an IRA's broader array of investments as an important factor.

- ▶ **Fees and Expenses**—Both plans and IRAs typically involve (i) investment-related expenses and (ii) plan or account fees. Investment-related expenses may include sales loads, commissions, the expenses of any mutual funds in which assets are invested and investment advisory fees. Plan fees typically include plan administrative fees (e.g., recordkeeping, compliance, trustee fees) and fees for services such as access to a customer service representative. In some cases, employers pay for some or all of the plan's administrative expenses.<sup>14</sup> An IRA's account fees may include, for example, administrative, account set-up and custodial fees.
- ▶ **Services**—An investor may wish to consider the different levels of service available under each option. Some plans, for example, provide access to investment advice, planning tools, telephone help lines, educational materials and workshops. Similarly, IRA providers offer different levels of service, which may include full brokerage service, investment advice, distribution planning and access to securities execution online.
- ▶ **Penalty-Free Withdrawals**—If an employee leaves her job between age 55 and 59½, she may be able to take penalty-free withdrawals from a plan. In contrast, penalty-free withdrawals generally may not be made from an IRA until age 59½. It also may be easier to borrow from a plan.
- ▶ **Protection from Creditors and Legal Judgments**—Generally speaking, plan assets have unlimited protection from creditors under federal law, while IRA assets are protected in bankruptcy proceedings only. State laws vary in the protection of IRA assets in lawsuits.
- ▶ **Required Minimum Distributions**—Once an individual reaches age 70½, the rules for both plans and IRAs require the periodic withdrawal of certain minimum amounts, known as the required minimum distribution. If a person is still working at age 70½, however, he generally is not required to make required minimum distributions from his current employer's plan. This may be advantageous for those who plan to work into their 70s.
- ▶ **Employer Stock**—An investor who holds significantly appreciated employer stock in a plan should consider the negative tax consequences of rolling the stock to an IRA. If employer stock is transferred in-kind to an IRA, stock appreciation will be taxed as ordinary income upon distribution.<sup>15</sup> The tax advantages of retaining employer stock in a non-qualified account should be balanced with the possibility that the investor may be excessively concentrated in employer stock. It can be risky to have too much employer stock in one's retirement account; for some investors, it may be advisable to liquidate the holdings and roll over the value to an IRA, even if it means losing long-term capital gains treatment on the stock's appreciation.

These are examples of the factors that may be relevant when analyzing available options, and the list is not exhaustive. Other considerations also might apply to specific circumstances.

### 3. Conflicts of Interest

Firms and their registered representatives that recommend an investor roll over plan assets to an IRA may earn commissions or other fees as a result. In contrast, a recommendation that an investor leave his plan assets with his old employer or roll the assets to a plan sponsored by a new employer likely results in little or no compensation for a firm or a registered representative. This conflict is not limited to the broker-dealer distribution channel. An investment adviser who recommends an investor roll over plan assets into an IRA may earn an asset-based fee as a result, but no compensation if assets are retained in the plan. Thus, a financial adviser has an economic incentive to encourage an investor to roll plan assets into an IRA that he will represent as either a broker-dealer or an investment adviser representative.<sup>16</sup>

Conflicts also may exist for firms and their associated persons that are responsible for educating plan participants about their choices. For example, if an associated person receives compensation for the number of IRAs that participants open at his firm, he has an incentive to encourage participants to open IRAs rather than maintain their assets in their plan.

FINRA urges broker-dealers to review their retirement services activities to assess conflicts of interest.<sup>17</sup> Firms must supervise these activities to reasonably ensure that conflicts of interest do not impair the judgment of a registered representative or another associated person about what is in the customer's interest and that they neither confuse investors nor interfere with important educational efforts.

### 4. Suitability and Fair Dealing

Implicit in all broker-dealer and associated person relationships with customers and others is the fundamental responsibility for fair dealing.<sup>18</sup> Rule 2111, FINRA's suitability rule, requires that a broker-dealer and its associated persons have a reasonable basis to believe that a recommended transaction or investment strategy involving a security is suitable for the customer.<sup>19</sup> A firm and its registered representatives, in making a recommendation, must consider the customer's investment profile, including the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the broker-dealer or registered representative in connection with the recommendation.

A recommendation concerning the type of retirement account in which a customer should hold his retirement investments typically involves a recommended securities transaction, and thus is subject to Rule 2111. For example, a firm may recommend that an investor sell his plan assets and roll over the cash proceeds into an IRA. Recommendations to sell securities in the plan or to purchase securities for a newly-opened IRA are subject to Rule 2111.<sup>20</sup>

If Rule 2111 is triggered, a registered representative must have a reasonable basis to believe that the recommendation is suitable for the customer, based on information about the options obtained through reasonable diligence, and taking into account factors such as tax implications, legal ramifications, and differences in services, fees and expenses between the retirement savings alternatives.<sup>21</sup>

Retirement plan assets typically constitute long-term investments by a customer. A registered representative must consider not only the immediate consequences of the recommendation, such as the potential tax penalties of early withdrawal from an employer sponsored plan, but also the eventual treatment under the Internal Revenue Code and other long-range effects of a particular choice. The registered representative should discuss with the customer the various factors related to the decision, in a manner reasonably likely to facilitate the investor's understanding. Some firms have adopted effective procedures under which an exception report is generated if a customer adds significant assets to an IRA.

Some firms and their associated persons provide educational information to plan participants concerning their retirement choices. Firms that permit educational information only should adopt measures reasonably designed to ensure that the firm and its associated persons do not make recommendations for purposes of Rule 2111 to plan participants. These measures should include training concerning what statements may trigger application of Rule 2111, and consideration of the compensation arrangements that could cause an associated person to make a recommendation. To the extent that a firm prohibits recommendations to plan participants, supervisory personnel of the firm should reasonably monitor the communications to ensure that the prohibition is not compromised.

#### **5. Supervision and Supervisory Control System**

Under NASD Rule 3010, broker-dealers must establish written supervisory procedures that are reasonably designed to ensure that their recommendations and marketing of IRA accounts and related services comply with applicable securities laws and FINRA rules. Written supervisory procedures should be reasonably designed to ensure that (i) registered representatives perform appropriate customer-specific suitability analyses and (ii) marketing materials are fair and balanced. Firms also are reminded that NASD Rule 3012 requires firms to test and verify that their written supervisory procedures are reasonably designed to ensure compliance with the federal securities laws and FINRA rules.<sup>22</sup>

## 6. Training of Registered Representatives

Firms must ensure that a registered representative who recommends a rollover to an IRA has been properly trained concerning retirement savings options and the tax, investment and other implications of the decision. Firms should update their training as needed if regulatory changes occur that are relevant to the decision whether to roll over plan assets. Firms should emphasize that performance of the suitability responsibilities of a broker-dealer or registered representative should never be compromised by their financial interest in recommending an IRA rollover or another action.

## 7. Communications With the Public

Under FINRA Rule 2210, firms must ensure that their communications with the public are based on principles of fair dealing and good faith, are fair and balanced, and provide a sound basis to evaluate the facts about any particular security or type of security, industry or service. No broker-dealer may omit any material fact or qualification if the omission, in light of the context of the material presented, would cause the communications to be misleading. No broker-dealer may make any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public, or publish, circulate or distribute any public communication that the broker-dealer knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

Rule 2210 applies to a broker-dealer's marketing of IRAs and related services. Whether in written sales material or an oral marketing campaign, it would be false and misleading to imply that a retiree's only choice, or only sound choice, is to roll over her plan assets to an IRA sponsored by the broker-dealer. The marketing of the IRA rollover services offered by the broker-dealer must be balanced by a discussion of other available options and how they compare to the IRA offered, particularly with regard to fees. As stated in [Regulatory Notice 13-23](#), any discussion of IRA fees must be fair and balanced. The broker-dealer may not claim that its IRAs are "free" or carry "no fee" when the investor will incur costs related to the account, account investments or both. If in marketing IRA rollovers a broker-dealer describes the various benefits of an IRA, the communication may be deemed misleading if it omits information needed to cause the description to be fair and balanced in terms of its comparison to other options.

## 8. FINRA Examinations of Firms

A determination to roll over plan assets to an IRA rather than keeping them in a previous employer's plan or rolling over to a new employer's plan should reflect consideration of various factors, the importance of which will depend on the customer's individual needs, circumstances and options. The recommendation and marketing of IRA rollovers will be an examination priority for FINRA in 2014.

## Endnotes

1. See, e.g., Gallup [video on retirement planning](#) and the Employee Benefit Research Institute's [2013 Retirement Confidence Survey](#). According to the Gallup poll, 61 percent of Americans are very or moderately worried about not having enough money for retirement. See also Department of Labor, "[Taking the Mystery Out of Retirement Planning](#)." ("The whole retirement scene has changed and many American workers find it a mystery.")
2. For ease of reference, this Notice addresses rollovers from 401(k) plans to IRAs. Similar considerations may arise in rollover decisions involving other types of employer-sponsored plans, such as 403(b) plans.
3. In a transfer, an investor does not take physical custody of plan assets; the assets move directly from the 401(k) plan to the IRA. In a rollover, an investor receives a check from the 401(k) plan after requesting liquidation and deposits the check into a rollover IRA within a certain period of time. For ease of reference, this Notice generally uses "rollover" to refer to both situations.
4. Not all employer plans accept rollovers. See Government Accountability Office 13-30, "Labor and IRS Could Improve the Rollover Process for Participants" at 8 (March 2013) ("GAO Report").
5. This option—taking a lump sum distribution that is not rolled over into another plan or an IRA—may be costly for many younger individuals. In general, tax penalties will apply if the employee is below age 59½ and the distribution will be taxed as ordinary income.
6. GAO stated that many experts indicate "[much] of the information and assistance participants receive is through the marketing efforts of service providers touting the benefits of IRA rollovers and is not always objective." See GAO Report at 22.
7. These rules include FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2210 (Communications with the Public) and 2111 (Suitability), and NASD Rules 3010 (Supervision) and 3012 (Supervisory Control Systems).  
  
See also [Regulatory Notice 13-23](#) (July 2013) (guidance concerning the marketing of "no-fee" IRAs.)
8. Rule 2111 applies only to explicit hold recommendations, and does not apply when a broker-dealer is silent regarding security positions in an account. See [Frequently Asked Questions FINRA Rule 2111 \(Suitability\)](#).
9. See Investment Company Institute (ICI) [Frequently Asked Questions About Individual Retirement Accounts](#) and 2013 Investment Company Fact Book at 114. In calculating defined contribution plan assets, the ICI included 401(k) plans, 403(b) plans, 457 plans, Keoghs and other defined contribution plans "without 401(k) features." In calculating IRA assets, the ICI included traditional IRAs, Roth IRAs and employer-sponsored IRAs (SEP IRAs, SAR-SEP IRAs and SIMPLE IRAs). The \$9 trillion in other retirement plans includes, among others, private-sector defined benefit plans, federal, state and local pension plans and all fixed and variable annuity reserves at life insurance companies less annuities held by IRAs, 403(b) plans, 457 plans and private pension funds.
10. See letter to Employee Benefits Security Administration from Davis & Harman, April 12, 2011 (transmitting study prepared by Oliver Wyman Inc.).
11. See ICI, [The U.S. Retirement Market](#), Second Quarter 2012 (September 2012).

## Endnotes (continued)

12. See ICI Research Perspective, [“The Role of IRAs in U.S. Households’ Saving for Retirement, 2013.”](#)
13. Not all IRAs permit a broad range of investments. For example, an IRA held with a mutual fund complex may limit investment to the complex’s funds.
14. See U.S. Department of Labor publication [A Look At 401\(k\) Plan Fees](#). See also Society for Human Resource Management [article](#) citing the 12th edition of the 401k Averages Book. The average total plan cost for a small retirement plan (no more than 100 participants) for all expenses bundled together, including investment fees deducted from participants’ assets and administrative, recordkeeping and trustee fees, paid by the plan sponsor or passed along to participants, was 1.3 percent of assets under management in 2011. The average total plan cost for a large plan (at least 1,000 participants) was slightly lower, at 1.08 percent.  
  
Individual service fees are charged separately to the accounts of participants who choose to take advantage of a particular plan feature, such as taking a loan from the plan. Other services may include, for example, provision of a toll-free telephone number for help and assistance. U.S. Department of Labor publication [A Look At 401\(k\) Plan Fees](#).
15. Generally, to obtain favorable tax treatment, an investor must (i) take a lump-sum distribution of all of his assets in the plan; (ii) request an in-kind distribution of the employer stock; and (iii) place the employer stock into a non-retirement account. Upon doing so, the investor will pay ordinary income tax on his cost basis (and a 10 percent penalty if under age 59½); when he sells the stock, however, he will pay long-term capital tax, not ordinary income tax, on the stock’s appreciation.
16. Similar conflicts may be presented for banks and other financial services firms that hold IRAs.
17. Firms should consider FINRA’s October 14, 2013, [Report on Conflicts of Interests](#), which highlights effective conflicts management practices that may go beyond current regulatory requirements.
18. See Rule 2111, Supplementary Material .01.
19. In addition to a customer-specific suitability determination, Rule 2111 requires reasonable-basis suitability (a determination that the recommendation is suitable for at least some investors) and quantitative suitability.
20. Many plans allow for in-kind distributions, which permits securities held in the plan by a participant to be transferred to a new qualified account. Certain holdings, however, such as institutional mutual funds that are available only to plan participants, may not be transferrable; such assets must be sold if an investor seeks to roll over to an IRA.
21. The rule generally does not apply to a communication that only describes a plan. See Rule 2111, Supplementary Material .03(b).
22. On December 23, 2013, the SEC issued an order approving FINRA’s proposed rule change to adopt rules regarding supervision in the consolidated FINRA rulebook. See Securities Exchange Act Release No. 71179 (December 23, 2013) (Order Approving File No. SR-FINRA-2013-025). FINRA will issue a *Regulatory Notice* announcing the effective date of the consolidated supervision rules.

# Election Notice

## FINRA Announces Results of SFAB, NAC and District Committee Elections

### Executive Summary

FINRA recently concluded elections to fill vacant seats on the Small Firm Advisory Board (SFAB), National Adjudicatory Council (NAC) and District Committees. Additionally, a number of individuals were appointed to fill vacancies on the SFAB, NAC and District Committees. This *Notice* lists the individuals elected and appointed to those seats for terms beginning January 1, 2014.

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

- ▶ Marcia Asquith, Senior Vice President and Corporate Secretary, at (202) 728-8949; or
- ▶ Jennifer Piorko Mitchell, Assistant Corporate Secretary, at (202) 728-8949.

### Small Firm Advisory Board Election Results

FINRA small firms in the New York Region elected the following individual to fill an open seat on the SFAB:

#### **New York Region Representative**

- ▶ **Steve Hart**, CCO, Robotti & Company, LLC

The FINRA Board also appointed the following individual as an At-Large SFAB Member:

- ▶ **Betsy Brennen**, Managing Partner and Chief Compliance Officer, Harbor Investment Advisory, LLC

Both Mr. Hart and Ms. Brennen will serve a three-year term beginning January 1, 2014.

**December 17, 2013**

#### Suggested Routing

- ▶ Executive Representative
- ▶ Senior Management

## National Adjudicatory Council

The following individuals were appointed<sup>1</sup> to fill seats on the NAC for a term beginning January 1, 2014.

### Mid-Size Firm NAC Member

**John R. Muschalek**                      Managing Director, First Southwest Company

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### Large Firm NAC Member

**Claire H. Santaniello**                      Chief Administrative Officer, Pershing, LLC

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### At-Large Industry NAC Member

**John Polanin, Jr.**                      Executive Director and Head of Compliance for the Americas, Macquarie Group Limited

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### Non-Industry NAC Member

**James E. Burton**                      Partner, California Strategies, LLC

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## District Committees

The following individuals were elected or appointed to serve on FINRA District Committees and will serve three-year terms (unless noted below) beginning January 1, 2014.

### District 1

- ▶ Small Firm Representative      **Robert Muh**, CEO, Sutter Securities, Inc.
  - ▶ Small Firm Representative (1-year term)      **Adrian E. Dollard**, Chief Operating Officer, Qatalyst Partners
  - ▶ Large Firm Representative      **James Williams**, President and Owner, Financial Telesis, Inc.
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### District 2

- ▶ Small Firm Representative      **Sandy Pappalardo**, Chief Operating Officer/Chief Compliance Officer/FINOP, Puplava Securities, Inc.
  - ▶ Mid-Size Firm Representative (1-year term)      **Susan Woltman Tietjen**, CEO, Girard Securities, Inc.
  - ▶ Large Firm Representative      **Mark Quinn**, Chief Risk Officer, First Allied Securities, Inc.
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**District 3**

- ▶ Small Firm Representative
- ▶ Large Firm Representative

**Alexis Vanden Bos**, CCO, E.K. Riley Investments, LLC

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**Bernard A. Breton**, VP & Chief Compliance Officer,  
Cetera Advisors LLC

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**District 4**

- ▶ Small Firm Representative
- ▶ Large Firm Representative

**Robert L. (Bob) Hamman**, President/CCO,  
First Asset Financial, Inc.

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**Robert T. Mooney**, Chief Compliance Officer,  
Wells Fargo Advisors, LLC

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**District 5**

- ▶ Small Firm Representative
- ▶ Large Firm Representative

**John L. Terry, III**, President/CEO, High Street Securities, Inc.

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**Mayo Woodward**, Branch Manager, Ameriprise Financial  
Services, Inc.

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**District 6**

- ▶ Small Firm Representative
- ▶ Large Firm Representative

**Ed Balsmann**, Chief Compliance Officer, Tudor, Pickering,  
Holt & Co. Securities, Inc.

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**Christopher Barton**, Executive Director/Complex Manager,  
Morgan Stanley

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**District 7**

- ▶ Small Firm Representative
- ▶ Large Firm Representative

**David Weinberger**, President/CFO/FINOP,  
CBG Financial Group, Inc.

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**Ken Bell**, Vice President, Audit, Cetera Advisor Networks

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**District 8**

- ▶ Small Firm Representative
- ▶ Large Firm Representative

**Lisa L. Lauria**, Co-CCO & Operations Manager,  
Thurston Springer Miller Herd & Titak, Inc.

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**William Hayden**, Chief Compliance Officer,  
Keybanc Capital Markets, Inc.

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**District 9**

- ▶ Small Firm Representative
- ▶ Large Firm Representative

**Peter M. Elish**, President, Peter Elish Investments Securities

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**Michael J. Carroll**, Regional President, Wells Fargo  
Advisors, LLC.

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**District 10**

- ▶ Small Firm Representative **Lew Breckenridge**, Chief Compliance Officer, KKR Capital Markets

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- ▶ Small Firm Representative **Nina J. Ihnken**, Vice President – Compliance, Abel/Noser Corp.

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- ▶ Large Firm Representative **Tracy Calder**, Managing Director, JP Morgan Chase & Co.

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- ▶ Large Firm Representative **Samuel Turvey**, Chief Compliance Officer, TIAA-CREF

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- ▶ Large Firm Representative (2-year term) **Andrew Weinberg**, Managing Director & Head of Regulatory Compliance & Assessment, Deutsche Bank Securities

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**District 11**

- ▶ Small Firm Representative **Jennifer Hoopes**, General Counsel, Funds Distributor, LLC

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- ▶ Large Firm Representative **Norman L. Ashkenas**, SVP, Chief Compliance Officer, Fidelity Brokerage Services, LLC

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**Endnote**

1. The Mid-Size NAC Member and Large Firm NAC Member were nominated by the Nominating Committee in July 2013 and their nominations were not contested.

# Information Notice

## 2014 Holiday Trade Date, Settlement Date and Margin Extensions Schedule

### Executive Summary

FINRA is providing the following schedule to assist firms and reduce the number of Federal Reserve Board Regulation T and Securities Exchange Act (SEA) Rule 15c3-3 extensions denied around holidays. “Regular way” transactions made on the business days that the securities exchanges are open will be subject to the schedule noted below.

Questions regarding this *Notice* should be directed to:

- ▶ Theresa Reynolds, Senior Credit Regulation Coordinator, Risk Oversight and Operational Regulation (ROOR), at (646) 315-8567; or
- ▶ Patricia Dorn, Project Manager, ROOR, at (646) 315-8559.

### Background

Brokers, dealers and municipal securities dealers should use the following settlement dates for clearing and settling securities transactions.

As specified in Sections 220.4(d) and 220.8(b)(4) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a margin account or cash account if payment is not received within five business days from the date of purchase or, pursuant to Section 220.4(c)(3) and 220.8(d)(1), apply to extend the time period specified. The date by which firms must take such action is shown below in the column titled “Regulation T Date.”

Similarly, SEA Rule 15c3-3 requires firms to take prompt steps to obtain possession or control of securities pursuant to paragraph (m) through a buy-in procedure or otherwise if securities are not received within ten business days from the settlement date of the sale or, pursuant to paragraph (n), apply to extend the time period specified. The date by which firms must take such action is shown below in the column titled “SEC Extension Date.”

December 23, 2013

### Suggested Routing

- ▶ Compliance
- ▶ Internal Audit
- ▶ Legal
- ▶ Municipal/Government Securities
- ▶ Operations
- ▶ Trading

### Key Topic(s)

- ▶ Holiday Extension Dates
- ▶ Holiday Settlement Dates

### Referenced Rules and Notices

- ▶ Regulation T 220.4 and 220.8
- ▶ SEA Rule 15c3-3

All SEA Rule 15c3-3 extension requests must be received on the due dates listed below. Adherence to this procedure will reduce the number of denied requests for improper dates and establish uniformity among regulated firms.<sup>1</sup>

SEA Rule 15c3-3 Subparagraph	Date Due
(d)(2)	- on the 30th calendar day after settlement date
(d)(3)	- on the 45th calendar day after settlement date
(h)	- on the 45th calendar day after settlement date
(m)	- on the 10th business day after settlement date

These dates also apply to a security listed on a foreign exchange. Firms must file SEA Rule 15c3-3 extensions on the appropriate dates regardless of the settlement cycle established by the foreign security market on which the security is traded.

### New Year's Day:

The securities exchanges will be closed on **Wednesday, January 1, 2014**, in observance of New Year's Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
December 24	December 30	January 2	January 14
26	31	3	15
27	January 2	6	16
30	3	7	17
31	6	8	21
January 1	<b>Markets Closed</b>	N/A	N/A
2	7	9	22

### Martin Luther King, Jr. Day:

The securities exchanges will be closed on **Monday, January 20, 2014**, in observance of Martin Luther King's birthday.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
January 13	January 16	January 21	January 31
14	17	22	February 3
15	21	23	4
16	22	24	5
17	23	27	6
20	<b>Markets Closed</b>	N/A	N/A
21	24	28	7

**Presidents' Day:**

The securities exchanges will be closed on **Monday, February 17, 2014**, in observance of Presidents' Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
February 10	February 13	February 18	February 28
11	14	19	March 3
12	18	20	4
13	19	21	5
14	20	24	6
17	<b>Markets Closed</b>	N/A	N/A
18	21	25	7

**Good Friday:**

The securities exchanges will be closed on **Friday, April 18, 2014**, in observance of Good Friday.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
April 11	April 16	April 21	May 1
14	17	22	2
15	21	23	5
16	22	24	6
17	23	25	7
18	<b>Markets Closed</b>	N/A	N/A
21	24	28	8

**Memorial Day:**

The securities exchanges will be closed on **Monday, May 26, 2014**, in observance of Memorial Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
May 19	May 22	May 27	June 6
20	23	28	9
21	27	29	10
22	28	30	11
23	29	June 2	12
26	<b>Markets Closed</b>	N/A	N/A
27	30	3	13

**Independence Day:**

The securities exchanges will be closed on **Friday, July 4, 2014**, in observance of Independence Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
June 27	July 2	July 7	July 17
30	3	8	18
July 1	7	9	21
2	8	10	22
3	9	11	23
4	<b>Markets Closed</b>	N/A	N/A
7	10	14	24

**Labor Day:**

The securities exchanges will be closed on **Monday, September 1, 2014**, in observance of Labor Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
August 25	August 28	September 2	September 12
26	29	3	15
27	September 2	4	16
28	3	5	17
29	4	8	18
September 1	<b>Markets Closed</b>	N/A	N/A
2	5	9	19

**Columbus Day:**

The securities exchanges will be **open** for trading on Columbus Day, **Monday, October 13, 2014**. Therefore, it is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board and for receiving customers' securities under SEA Rule 15c3-3. However, it will not be a settlement date because many banking institutions will be closed.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
October 6	October 9	October 13	October 23
7	10	14	24
8	14	15	28
9	15	16	29
10	16	17	30
13	16	20	30
14	17	21	31

**Veteran's Day:**

The securities exchanges will be **open** for trading on Veteran's Day, **Tuesday, November 11, 2014**. Therefore, it is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board and for receiving customers' securities under SEA Rule 15c3-3. However, it will not be a settlement date because many banking institutions will be closed.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
November 4	November 7	November 11	November 21
5	10	12	24
6	12	13	26
7	13	14	28
10	14	17	December 1
11	14	18	1
12	17	19	2

**Thanksgiving Day:**

The securities exchanges will be **closed** on **Thursday, November 27, 2014**, in observance of Thanksgiving Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
November 20	November 25	November 28	December 10
21	26	December 1	11
24	28	2	12
25	December 1	3	15
26	2	4	16
27	<b>Markets Closed</b>	N/A	N/A
28	3	5	17

**Christmas Day:**

The securities exchanges will be **closed** on **Thursday, December 25, 2014**, in observance of Christmas Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
December 18	December 23	December 26	January 8, 2015
19	24	29	9
22	26	30	12
23	29	31	13
24	30	January 2	14
25	<b>Markets Closed</b>	N/A	N/A
26	31	5	15

**Endnote**

1. Firms are reminded that, with regards to SEA Rule 15c3-3 extensions of time, all extension dates that are affected by these holidays may not be displayed. Firms should apply the same procedures to ensure compliance with these guidelines.