

Proposed Rule Change by Financial Industry Regulatory Authority  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial <input checked="" type="checkbox"/>	Amendment <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) <input checked="" type="checkbox"/>	Section 19(b)(3)(A) <input type="checkbox"/>	Section 19(b)(3)(B) <input type="checkbox"/>
			Rule		
			<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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**Description**  
Provide a brief description of the proposed rule change (limit 250 characters).

Proposed rule change to adopt FINRA Rules 2350 through 2359 (regarding Trading in Index Warrants, Currency Index Warrants and Currency Warrants), FINRA Rule 2360 (Options) and FINRA Rule 2370 (Security Futures) in the Consolidated FINRA Rulebook

**Contact Information**  
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name	<input type="text" value="Kathryn"/>	Last Name	<input type="text" value="Moore"/>
Title	<input type="text" value="Assistant General Counsel"/>		
E-mail	<input type="text" value="kathryn.moore@finra.org"/>		
Telephone	<input type="text" value="(202) 974-2974"/>	Fax	<input type="text" value="(202) 728-8264"/>

**Signature**  
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date	<input type="text" value="07/29/2008"/>
By	<input type="text" value="Gary L. Goldsholle"/>
	(Name)
	<input type="text" value="Vice President and Associate General Counsel"/>
	(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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

**Form 19b-4 Information**

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

**Exhibit 1 - Notice of Proposed Rule Change**

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

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

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Exhibit Sent As Paper Document

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

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

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Exhibit Sent As Paper Document

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

**Exhibit 4 - Marked Copies**

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

**Exhibit 5 - Proposed Rule Text**

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

**Partial Amendment**

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

**1. Text of Proposed Rule Change**

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to adopt NASD Rules 2840 through 2853 regarding Trading in Index Warrants, Currency Index Warrants and Currency Warrants, 2860 (Options), and 2865 (Security Futures) as FINRA Rules in the consolidated FINRA rulebook and to delete the corresponding provisions in Incorporated NYSE Rules 414 (Index and Currency Warrants), 424 (Report of Options) and the 700 Series (Option Rules). The proposed rule change would renumber NASD Rules 2840 through 2853 as FINRA Rules 2350 through 2359, NASD Rule 2860 as FINRA Rule 2360 and NASD Rule 2865 as FINRA Rule 2370 in the consolidated FINRA rulebook.

The text of the proposed rule change is attached as Exhibit 5 to this rule filing.

(b) Upon Commission approval and implementation of the proposed rule change, the corresponding NASD rules and Incorporated NYSE rules will be eliminated from the current FINRA rulebook.

(c) Not applicable.

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

**2. Procedures of the Self-Regulatory Organization**

At its meeting on April 17, 2008, the FINRA Board of Governors authorized the filing of the rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval.

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

(a) Purpose

As part of the process of developing the new consolidated rulebook (the "Consolidated FINRA Rulebook"),<sup>2</sup> FINRA is proposing to adopt, with minor changes described below, (1) NASD Rules 2840 through 2853 (regarding Trading in Index Warrants, Currency Index Warrants and Currency Warrants) as FINRA Rules 2350 through 2359; (2) NASD Rule 2860 (Options) as FINRA Rule 2360; and (3) NASD Rule 2865 (Security Futures) as FINRA Rule 2370.

The warrants, options and security futures rules were adopted to address the specific risks that pertain to these derivative securities, and implement provisions of the

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<sup>2</sup> The current FINRA rulebook consists of two sets of rules: (1) NASD Rules and (2) rules incorporated from NYSE ("Incorporated NYSE Rules") (together referred to as the "Transitional Rulebook"). The Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE ("Dual Members"). Dual Members also must comply with NASD Rules. For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process).

federal securities laws and SEC rules.<sup>3</sup> These rules include, among other things, provisions requiring specific disclosure documents, additional diligence in approving the opening of accounts, and specific requirements for confirmations, account statements, suitability, recordkeeping and reporting. The rules also contain provisions imposing limits on the size of an options or warrant position and on the number of options contracts or warrants that can be exercised during a fixed period.

#### Warrant Rules

FINRA proposes to adopt NASD rules on index warrants, currency index warrants and currency warrants, NASD Rules 2840 through 2853, as FINRA Rules 2350 through 2359, in substantially the form they exist today. The proposed rule change would reorganize certain requirements, grouping them along similar subject matter lines, by combining the statement of general applicability and definitions into a single rule (FINRA Rule 2351), and creating a single rule addressing position and exercise limits and liquidations (FINRA Rule 2359).

#### Options Rule

As further described below, FINRA proposes to adopt NASD Rule 2860 as FINRA Rule 2360 with minor modifications to (1) delete obsolete definitions; (2) change all references to “Registered Options and Security Futures Principal” to “Registered Options Principal;” (3) permit a Limited Principal-General Securities Sales Supervisor to approve the opening of an options account; (4) modify the confirmation disclosure

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<sup>3</sup> For example, Exchange Act Rule 9b-1(d) requires a broker-dealer to furnish a customer with a copy of the options disclosure document before accepting an options order from a customer.

requirements consistent with recent changes to the equity confirmation disclosure requirements; (5) incorporate NASD Interpretative Materials 2860-1 and 2860-2 into the rule text or as Supplementary Material; and (6) codify as Supplementary Material the provisions in NASD Notice to Members 07-03 regarding control relationships.

First, FINRA proposes to delete extraneous definitions from the options rule, many of which became obsolete once the provisions in the options rule pertaining to NASDAQ options were deleted following the separation of NASDAQ from NASD.<sup>4</sup>

Second, FINRA proposes to change the term “Registered Options and Security Futures Principal” to “Registered Options Principal.”<sup>5</sup> The term Registered Options Principal (“ROP”) was recently changed to Registered Options and Security Futures Principal (“ROSFP”).<sup>6</sup> However, FINRA believes that the change to ROSFP has generated confusion among the members and believes that reverting to ROP will alleviate these issues. In addition, FINRA believes using the term ROP would promote consistency with the rules of the options exchanges all of which use the term ROP.

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<sup>4</sup> See Securities Exchange Act Release No. 54084 (June 30, 2006), 71 FR 38935 (July 10, 2006) (Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 Relating to Amendments to the NASD’s Rules Following the Nasdaq Exchange’s Operation as a National Securities Exchange for Nasdaq UTP Plan Securities. File No. SR-NASD-2005-087).

<sup>5</sup> Upon approval of the proposed rule change, FINRA intends to make conforming changes in an immediately effective rule filing to NASD Rule 1022 and IM-1022-1 to change the term ROSFP to ROP. In addition, FINRA plans to make same conforming change to NASD Rule 2220 as part of SR-FINRA-2008-013.

<sup>6</sup> See Securities Exchange Act Release No 57775 (May 5, 2008), 73 FR 26453 (May 9, 2008) (Approval Order of SR-FINRA-2007-035).

FINRA notes that the change to the principal title does not affect the qualifications needed to supervise options or security futures.<sup>7</sup>

Third, FINRA proposes greater flexibility in the area of account approval in FINRA Rule 2360(b)(16)(B) to allow a Limited Principal-General Securities Sales Supervisor (Series 9/10) - in addition to a ROP (Series 4) - to approve the opening of an options account. The proposed rule change is consistent with CBOE Rule 9.7 (Opening of Accounts) which permits a Series 9/10 qualified individual serving as a branch manager to approve the opening of an options account.<sup>8</sup> Under NASD Rule 2860, a Series 9/10 may supervise options trading activity, but may not approve the opening of an options account. FINRA believes that individuals who have passed the Series 9/10 examination are sufficiently qualified to review and approve the opening of an options account.

Fourth, consistent with recent changes in the listed equity markets, FINRA proposes, in adopting FINRA Rule 2360(b)(12), to eliminate the current requirement that

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<sup>7</sup> In order to supervise security futures, an individual must successfully pass the Series 4 examination and complete a firm-element continuing education program on security futures. See NASD Notice to Members 02-73 (November 2002) (SEC Approves New Rules and Rule Amendments Concerning Security Futures). Individuals supervising only options are not required to complete a firm-element continuing education program on security futures.

<sup>8</sup> See also CBOE Rule 9.2 and Interpretation .01 and .02, which specifies the qualification requirements for individuals designated as Registered Options Principals.

an options confirmation specify the exchange(s) upon which the option transaction was executed.<sup>9</sup>

Fifth, FINRA proposes to relocate the illustrations of position limit calculations in NASD IM-2860-1 (Position Limits) to Supplementary Material .01 of FINRA Rule 2360 and incorporate the provisions from NASD IM-2860-2 (Diligence in Opening Options Accounts) pertaining to opening of options accounts into FINRA Rule 2360(b)(16)(B) and (b)(16)(C).<sup>10</sup>

Sixth, FINRA proposes to codify as Supplementary Material .02 to FINRA Rule 2360 the provisions in NASD Notice to Members 07-03 pertaining to control relationships, which are explicitly incorporated in NASD Rule 2860(b)(3)(A)(vii)b.2.B.i. NASD Notice to Members 07-03 sets forth the conditions under which FINRA will deem that no control relationship exists between affiliates and between separate and distinct trading units within the same entity. FINRA believes that adding the relevant provisions of NASD Notice to Members 07-03 as Supplementary Material will make the rule more self-contained and easier to follow.

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<sup>9</sup> See Securities Exchange Act Release No. 57045 (December 27, 2007) 73 FR 529 (January 3, 2008) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA 2007-037). See also FINRA Regulatory Notice 07-65 (December 2007) (FINRA Amends NYSE Rule 409(f) (Statements of Accounts to Customers) to Eliminate the Requirement to Include the Name of the Securities Market on which a Transaction is Effected).

<sup>10</sup> Provisions regarding verification of a customer's background and financial information have transferred unchanged to FINRA Rule 2360(b)(16)(C). Members are reminded that they can only recommend transactions for the purchase or sale (writing) of option contracts if they have reasonable grounds for believing, at the time of making the recommendation based on any information known by the member or associated person, that the recommended transaction is not unsuitable for the customer. See NASD Rule 2860(b)(19).



### Security Futures Rule

FINRA proposes to adopt NASD Rule 2865 as FINRA Rule 2370 with minor changes to preserve the general parallel treatment of options and security futures.<sup>11</sup> In particular, FINRA proposes to update the provisions regarding discretionary accounts to conform to recent rule amendments made to the options rule.<sup>12</sup> Under the proposed rule change, each firm must designate specific principals qualified to supervise security futures activities to review discretionary accounts.<sup>13</sup> A principal other than the principal who accepted the account must review the acceptance of each discretionary account to determine that the principal accepting the account had a reasonable basis for believing that the customer was able to understand and bear the risks of the strategies or transactions proposed and must maintain a record of the basis for such determination.

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<sup>11</sup> One of the underpinnings of the Commodity Futures Modernization Act of 2000 is that the regulation of security futures should be comparable to the regulation of options. In approving NASD Rule 2865 (Securities Futures), the SEC stated: “The system of joint regulation of security futures established by the Commodity Futures Modernization Act is intended to prevent competitive advantages from arising solely out of differences between securities regulation and futures regulation.... The Commission believes that the rule change should promote just and equitable principles of trade by preventing regulatory disparities from occurring between options and security futures.” See Securities Exchange Act Release No. 46663 (October 15, 2002) 67 FR 64944, 64947 (October 22, 2002) (Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 2 and 3 to SR-NASD-2002-040).

<sup>12</sup> See Securities Exchange Act Release No. 57775 (May 5, 2008), 73 FR 26453 (May 9, 2008) (Order Approving SR-FINRA-2007-035).

<sup>13</sup> As provided in NASD Rule 1022(f)(5), any ROP that supervises security futures products must complete a firm-element continuing education program that addresses security futures and a principal’s responsibilities for supervising such products.

To mirror recent changes to the options rule, the proposed rule change would eliminate the requirement that discretionary orders be approved on the day of entry by a principal qualified to supervise security futures activities if a firm uses computerized surveillance tools. Discretionary orders for firms using computerized surveillance tools instead may be reviewed in accordance with the member firm's written supervisory procedures. Firms that do not use computerized surveillance tools must, as they do today, establish and implement procedures requiring principals qualified to supervise security futures activities who have been designated to review discretionary accounts to approve and initial each discretionary order on the day entered.<sup>14</sup>

Finally, FINRA proposes to limit the duration of the time and price discretionary authority to the end of the business day on which the customer granted such discretion, absent specific written contrary indication signed and dated by the customer. This limitation would not apply to discretion exercised in an institutional account, as defined in NASD Rule 3110(c)(4), pursuant to Good-Till-Canceled instructions issued on a "not held" basis. The proposed rule change would require that any exercise of time and price discretion be reflected on the order ticket. These changes mirror the limitations to discretionary authority provided in NASD Rule 2510(d) and the options rule.

#### Deleted Rules

FINRA proposes to delete the following Incorporated NYSE Rules as the substance of such rules is addressed in the proposed FINRA rules:<sup>15</sup> Incorporated NYSE

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<sup>14</sup> See supra note 12.

<sup>15</sup> Moreover, in several instances, the Incorporated NYSE Rules are no longer applicable by their own terms as the NYSE no longer trades options.

Rules 414 (Index and Currency Warrants); 424 (Reports of Options); 700 (Applicability, Definitions and References); 704 (Position Limits); 705 (Exercise Limits); 707 (Liquidation of Positions); 709 (Other Restrictions on Exchange Option Transactions and Exercises); 720 (Registration of Options Principals); 721 (Opening of Accounts); 722 (Supervision of Accounts); 723 (Suitability); 724 (Discretionary Accounts); 725 (Confirmations); 726 (Delivery of Options Disclosure Document and Prospectus); 727 (Transactions with Issuers); 728 (Restricted Stock); 730 (Statement of Accounts); 732 (Customer Complaints); 780 (Exercise of Option Contracts); 781 (Allocation of Exercise Assignment Notices); and 791 (Communications to Customers).

As noted in Item 2 of this filing, FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>16</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change makes minor changes to rules that have proven effective in meeting the statutory mandates. Moreover, as described in the proposed rule change, certain amended provisions seek to conform FINRA rules to existing provisions of other self-regulatory organizations or are consistent with other rule changes. FINRA

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<sup>16</sup> 15 U.S.C. 78o-3(b)(6).

believes that the proposed rules promote the public interest and protect investors who invest in and trade these derivative products.

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

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments were neither solicited nor received.

**6. Extension of Time Period for Commission Action**

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.<sup>17</sup>

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

Not applicable.

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

Not applicable.

**9. Exhibits**

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 5. Text of the proposed rule change.

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<sup>17</sup> 15 U.S.C. 78s(b)(2).

**EXHIBIT 1**

**SECURITIES AND EXCHANGE COMMISSION**

(Release No. 34- ; File No. SR-FINRA-2008-032)

Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to adopt FINRA Rules 2350 through 2359 (regarding Trading in Index Warrants, Currency Index Warrants and Currency Warrants), FINRA Rule 2360 (Options) and FINRA Rule 2370 (Security Futures) in the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on , Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

FINRA is proposing to adopt NASD Rules 2840 through 2853 regarding Trading in Index Warrants, Currency Index Warrants and Currency Warrants, 2860 (Options), and 2865 (Security Futures) as FINRA Rules in the consolidated FINRA rulebook and to delete the corresponding provisions in Incorporated NYSE Rules 414 (Index and Currency Warrants), 424 (Report of Options) and the 700 Series (Option Rules). The proposed rule change would renumber NASD Rules 2840 through 2853 as FINRA Rules

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

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

2350 through 2359, NASD Rule 2860 as FINRA Rule 2360 and NASD Rule 2865 as FINRA Rule 2370 in the consolidated FINRA rulebook.

The text of the proposed rule change is attached as Exhibit 5 to this rule filing.

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

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

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

1. Purpose

As part of the process of developing the new consolidated rulebook (the “Consolidated FINRA Rulebook”),<sup>3</sup> FINRA is proposing to adopt, with minor changes described below, (1) NASD Rules 2840 through 2853 (regarding Trading in Index Warrants, Currency Index Warrants and Currency Warrants) as FINRA Rules 2350 through 2359; (2) NASD Rule 2860 (Options) as FINRA Rule 2360; and (3) NASD Rule 2865 (Security Futures) as FINRA Rule 2370.

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<sup>3</sup> The current FINRA rulebook consists of two sets of rules: (1) NASD Rules and (2) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together referred to as the “Transitional Rulebook”). The Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). Dual Members also must comply with NASD Rules. For more information about the rulebook consolidation process, see [FINRA Information Notice](#), March 12, 2008 (Rulebook Consolidation Process).

The warrants, options and security futures rules were adopted to address the specific risks that pertain to these derivative securities, and implement provisions of the federal securities laws and SEC rules.<sup>4</sup> These rules include, among other things, provisions requiring specific disclosure documents, additional diligence in approving the opening of accounts, and specific requirements for confirmations, account statements, suitability, recordkeeping and reporting. The rules also contain provisions imposing limits on the size of an options or warrant position and on the number of options contracts or warrants that can be exercised during a fixed period.

#### Warrant Rules

FINRA proposes to adopt NASD rules on index warrants, currency index warrants and currency warrants, NASD Rules 2840 through 2853, as FINRA Rules 2350 through 2359, in substantially the form they exist today. The proposed rule change would reorganize certain requirements, grouping them along similar subject matter lines, by combining the statement of general applicability and definitions into a single rule (FINRA Rule 2351), and creating a single rule addressing position and exercise limits and liquidations (FINRA Rule 2359).

#### Options Rule

As further described below, FINRA proposes to adopt NASD Rule 2860 as FINRA Rule 2360 with minor modifications to (1) delete obsolete definitions; (2) change all references to “Registered Options and Security Futures Principal” to “Registered Options Principal;” (3) permit a Limited Principal-General Securities Sales Supervisor to

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<sup>4</sup> For example, Exchange Act Rule 9b-1(d) requires a broker-dealer to furnish a customer with a copy of the options disclosure document before accepting an options order from a customer.

approve the opening of an options account; (4) modify the confirmation disclosure requirements consistent with recent changes to the equity confirmation disclosure requirements; (5) incorporate NASD Interpretative Materials 2860-1 and 2860-2 into the rule text or as Supplementary Material; and (6) codify as Supplementary Material the provisions in NASD Notice to Members 07-03 regarding control relationships.

First, FINRA proposes to delete extraneous definitions from the options rule, many of which became obsolete once the provisions in the options rule pertaining to NASDAQ options were deleted following the separation of NASDAQ from NASD.<sup>5</sup>

Second, FINRA proposes to change the term “Registered Options and Security Futures Principal” to “Registered Options Principal.”<sup>6</sup> The term Registered Options Principal (“ROP”) was recently changed to Registered Options and Security Futures Principal (“ROSFP”).<sup>7</sup> However, FINRA believes that the change to ROSFP has generated confusion among the members and believes that reverting to ROP will alleviate these issues. In addition, FINRA believes using the term ROP would promote consistency with the rules of the options exchanges all of which use the term ROP.

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<sup>5</sup> See Securities Exchange Act Release No. 54084 (June 30, 2006), 71 FR 38935 (July 10, 2006) (Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 Relating to Amendments to the NASD’s Rules Following the Nasdaq Exchange’s Operation as a National Securities Exchange for Nasdaq UTP Plan Securities. File No. SR-NASD-2005-087).

<sup>6</sup> Upon approval of the proposed rule change, FINRA intends to make conforming changes in an immediately effective rule filing to NASD Rule 1022 and IM-1022-1 to change the term ROSFP to ROP. In addition, FINRA plans to make same conforming change to NASD Rule 2220 as part of SR-FINRA-2008-013.

<sup>7</sup> See Securities Exchange Act Release No 57775 (May 5, 2008), 73 FR 26453 (May 9, 2008) (Approval Order of SR-FINRA-2007-035).



FINRA notes that the change to the principal title does not affect the qualifications needed to supervise options or security futures.<sup>8</sup>

Third, FINRA proposes greater flexibility in the area of account approval in FINRA Rule 2360(b)(16)(B) to allow a Limited Principal-General Securities Sales Supervisor (Series 9/10) - in addition to a ROP (Series 4) - to approve the opening of an options account. The proposed rule change is consistent with CBOE Rule 9.7 (Opening of Accounts) which permits a Series 9/10 qualified individual serving as a branch manager to approve the opening of an options account.<sup>9</sup> Under NASD Rule 2860, a Series 9/10 may supervise options trading activity, but may not approve the opening of an options account. FINRA believes that individuals who have passed the Series 9/10 examination are sufficiently qualified to review and approve the opening of an options account.

Fourth, consistent with recent changes in the listed equity markets, FINRA proposes, in adopting FINRA Rule 2360(b)(12), to eliminate the current requirement that an options confirmation specify the exchange(s) upon which the option transaction was executed.<sup>10</sup>

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<sup>8</sup> In order to supervise security futures, an individual must successfully pass the Series 4 examination and complete a firm-element continuing education program on security futures. See NASD Notice to Members 02-73 (November 2002) (SEC Approves New Rules and Rule Amendments Concerning Security Futures). Individuals supervising only options are not required to complete a firm-element continuing education program on security futures.

<sup>9</sup> See also CBOE Rule 9.2 and Interpretation .01 and .02, which specifies the qualification requirements for individuals designated as Registered Options Principals.

<sup>10</sup> See Securities Exchange Act Release No. 57045 (December 27, 2007) 73 FR 529 (January 3, 2008) (Notice of Filing and Immediate Effectiveness of File No. SR-

Fifth, FINRA proposes to relocate the illustrations of position limit calculations in NASD IM-2860-1 (Position Limits) to Supplementary Material .01 of FINRA Rule 2360 and incorporate the provisions from NASD IM-2860-2 (Diligence in Opening Options Accounts) pertaining to opening of options accounts into FINRA Rule 2360(b)(16)(B) and (b)(16)(C).<sup>11</sup>

Sixth, FINRA proposes to codify as Supplementary Material .02 to FINRA Rule 2360 the provisions in NASD Notice to Members 07-03 pertaining to control relationships, which are explicitly incorporated in NASD Rule 2860(b)(3)(A)(vii)b.2.B.i. NASD Notice to Members 07-03 sets forth the conditions under which FINRA will deem that no control relationship exists between affiliates and between separate and distinct trading units within the same entity. FINRA believes that adding the relevant provisions of NASD Notice to Members 07-03 as Supplementary Material will make the rule more self-contained and easier to follow.

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FINRA 2007-037). See also FINRA Regulatory Notice 07-65 (December 2007) (FINRA Amends NYSE Rule 409(f) (Statements of Accounts to Customers) to Eliminate the Requirement to Include the Name of the Securities Market on which a Transaction is Effected).

<sup>11</sup> Provisions regarding verification of a customer's background and financial information have transferred unchanged to FINRA Rule 2360(b)(16)(C). Members are reminded that they can only recommend transactions for the purchase or sale (writing) of option contracts if they have reasonable grounds for believing, at the time of making the recommendation based on any information known by the member or associated person, that the recommended transaction is not unsuitable for the customer. See NASD Rule 2860(b)(19).

Security Futures Rule

FINRA proposes to adopt NASD Rule 2865 as FINRA Rule 2370 with minor changes to preserve the general parallel treatment of options and security futures.<sup>12</sup> In particular, FINRA proposes to update the provisions regarding discretionary accounts to conform to recent rule amendments made to the options rule.<sup>13</sup> Under the proposed rule change, each firm must designate specific principals qualified to supervise security futures activities to review discretionary accounts.<sup>14</sup> A principal other than the principal who accepted the account must review the acceptance of each discretionary account to determine that the principal accepting the account had a reasonable basis for believing that the customer was able to understand and bear the risks of the strategies or transactions proposed and must maintain a record of the basis for such determination.

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<sup>12</sup> One of the underpinnings of the Commodity Futures Modernization Act of 2000 is that the regulation of security futures should be comparable to the regulation of options. In approving NASD Rule 2865 (Securities Futures), the SEC stated: “The system of joint regulation of security futures established by the Commodity Futures Modernization Act is intended to prevent competitive advantages from arising solely out of differences between securities regulation and futures regulation.... The Commission believes that the rule change should promote just and equitable principles of trade by preventing regulatory disparities from occurring between options and security futures.” See Securities Exchange Act Release No. 46663 (October 15, 2002) 67 FR 64944, 64947 (October 22, 2002) (Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 2 and 3 to SR-NASD-2002-040).

<sup>13</sup> See Securities Exchange Act Release No. 57775 (May 5, 2008), 73 FR 26453 (May 9, 2008) (Order Approving SR-FINRA-2007-035).

<sup>14</sup> As provided in NASD Rule 1022(f)(5), any ROP that supervises security futures products must complete a firm-element continuing education program that addresses security futures and a principal’s responsibilities for supervising such products.

To mirror recent changes to the options rule, the proposed rule change would eliminate the requirement that discretionary orders be approved on the day of entry by a principal qualified to supervise security futures activities if a firm uses computerized surveillance tools. Discretionary orders for firms using computerized surveillance tools instead may be reviewed in accordance with the member firm's written supervisory procedures. Firms that do not use computerized surveillance tools must, as they do today, establish and implement procedures requiring principals qualified to supervise security futures activities who have been designated to review discretionary accounts to approve and initial each discretionary order on the day entered.<sup>15</sup>

Finally, FINRA proposes to limit the duration of the time and price discretionary authority to the end of the business day on which the customer granted such discretion, absent specific written contrary indication signed and dated by the customer. This limitation would not apply to discretion exercised in an institutional account, as defined in NASD Rule 3110(c)(4), pursuant to Good-Till-Canceled instructions issued on a "not held" basis. The proposed rule change would require that any exercise of time and price discretion be reflected on the order ticket. These changes mirror the limitations to discretionary authority provided in NASD Rule 2510(d) and the options rule.

#### Deleted Rules

FINRA proposes to delete the following Incorporated NYSE Rules as the substance of such rules is addressed in the proposed FINRA rules:<sup>16</sup> Incorporated NYSE Rules 414 (Index and Currency Warrants); 424 (Reports of Options); 700 (Applicability,

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<sup>15</sup> See supra note 13.

<sup>16</sup> Moreover, in several instances, the Incorporated NYSE Rules are no longer applicable by their own terms as the NYSE no longer trades options.

Definitions and References); 704 (Position Limits); 705 (Exercise Limits); 707 (Liquidation of Positions); 709 (Other Restrictions on Exchange Option Transactions and Exercises); 720 (Registration of Options Principals); 721 (Opening of Accounts); 722 (Supervision of Accounts); 723 (Suitability); 724 (Discretionary Accounts); 725 (Confirmations); 726 (Delivery of Options Disclosure Document and Prospectus); 727 (Transactions with Issuers); 728 (Restricted Stock); 730 (Statement of Accounts); 732 (Customer Complaints); 780 (Exercise of Option Contracts); 781 (Allocation of Exercise Assignment Notices); and 791 (Communications to Customers).

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>17</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change makes minor changes to rules that have proven effective in meeting the statutory mandates. Moreover, as described in the proposed rule change, certain amended provisions seek to conform FINRA rules to existing provisions of other self-regulatory organizations or are consistent with other rule changes. FINRA believes that the proposed rules promote the public interest and protect investors who invest in and trade these derivative products.

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<sup>17</sup> 15 U.S.C. 78o-3(b)(6).

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

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

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

Electronic Comments:

- Use the Commission's Internet comment form

(<http://www.sec.gov/rules/sro.shtml>); or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2008-032 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Florence Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2008-032. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of FINRA.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2008-032 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>18</sup>

Florence Harmon

Acting Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).



**EXHIBIT 5**

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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**Text of Proposed New FINRA Rules  
(marked to show changes from NASD Rules 2840 through 2865; NASD Rules 2840  
though 2865 to be deleted in their entirety from the Transitional Rulebook)**

\* \* \* \* \*

[2800.] **2300. SPECIAL PRODUCTS**

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[2840.] **2350. Trading in Index Warrants, Currency Index Warrants[,] and  
Currency Warrants**

[2841.] **2351. General Provisions Applicable to Trading in Index Warrants,  
Currency Index Warrants and Currency Warrants**

**(a) General**

[(a)] (1) Applicability — This Rule [2840] 2350 Series shall be applicable to the extent appropriate unless otherwise stated herein, to the conduct of accounts, the execution of transactions, and the handling of orders in exchange-listed stock index warrants, currency index warrants, and currency warrants by members who are not members of the exchange on which the warrant is listed or traded.

[(b)] (2) Except to the extent that specific provisions in this Rule Series govern, or unless the context otherwise requires, the provisions of the FINRA By-Laws, [R]rules [of the Association] and all other interpretations and policies shall also be

applicable to transactions in index warrants, currency index warrants, and currency warrants.

[(c)] (3) The Rules in this Rule [2840] 2350 Series are not applicable to stock index warrants, currency index warrants, and currency warrants listed on national securities exchanges prior to September 28, 1995.

**[2842.] (b) Definitions**

[(a)] (1) The term “control” shall have the same meaning as the term “control” as set forth in Rule [2860(b)(2)(L)] 2360(a)(6).

[(b)] (2) The term “currency index” means a group of currencies each of whose inclusion and relative representation in the group is determined by its inclusion and relative representation in a currency index.

[(c)] (3) The term “currency index warrants” shall mean instruments that are direct obligations of the issuing company, either exercisable throughout their life (i.e., American style) or exercisable only on their expiration date (i.e., European style), entitling the holder thereof to a cash settlement in U.S. dollars to the extent that the value of the underlying currency index has declined below (in the case of a put warrant) or increased above (in the case of a call warrant) the pre-stated cash settlement value of the underlying currency index.

[(d)] (4) The term “currency warrants” shall mean instruments that are direct obligations of the issuing company, either exercisable throughout their life (i.e., American style) or exercisable only on their expiration date (i.e., European style), entitling the holder thereof to a cash settlement in U.S. dollars to the extent that the value of the underlying foreign currency has declined below (in the case of a

put warrant) or increased above (in the case of a call warrant) the pre-stated cash settlement value of the underlying foreign currency. The term “foreign currency warrants” shall also include cross-rate currency warrants.

[(e)] (5) The term “index warrants” means instruments that are direct obligations of the issuing company, either exercisable throughout their life (i.e., American style) or exercisable only on their expiration date (i.e., European style), entitling the holder thereof to a cash settlement in U.S. dollars to the extent that the value of the underlying stock index group has declined below (in the case of a put warrant) or increased above (in the case of a call warrant) the pre-stated cash settlement value of the underlying stock index group.

[(f)] (6) The term “stock index group” means a group of stocks each of whose inclusion and relative representation in the group is determined by its inclusion and relative representation in a stock index.

**[2843.] 2352. Account Approval**

No member or person associated with a member shall accept an order from a customer to purchase or sell an index warrant, currency index warrant, or currency warrant unless the customer’s account has been approved for options trading pursuant to [2860] Rule 2360(b)(16).

**[2844.] 2353. Suitability**

The provisions of Rule [2860] 2360(b)(19) shall apply to recommendations by members and persons associated with members regarding the purchase or sale of index warrants, currency index warrants, or currency warrants. The term “option” as used therein shall be deemed to include such warrants for purposes of this Rule.

**[2845.] 2354. Discretionary Accounts**

Insofar as a member or person associated with a member exercises discretion to trade in index warrants, currency index warrants, or currency warrants in a customer's account, such account shall be subject to the provisions of Rule [2860] 2360(b)(18). The term "option" as used therein shall be deemed to include such warrants for purposes of this Rule.

**[2846.] 2355. Supervision of Accounts**

The provisions of Rule [2860] 2360(b)(20) shall apply to all customer accounts of a member in which transactions in index warrants, currency index warrants, or currency warrants are effected. The term "option" as used therein shall be deemed to include such warrants for purposes of this Rule.

**[2847.] 2356. Customer Complaints**

The record-keeping requirements of Rule [2860] 2360(b)(17)(A) concerning the receipt and handling of customer complaints relating to options shall also apply to customer complaints relating to index warrants, currency index warrants, or currency warrants and the required records of such complaints shall be maintained together with the records pertaining to options related complaints, provided that complaints related to index warrants, currency index warrants, or currency warrants shall be clearly identified as such. The term "option" as used therein shall be deemed to include such warrants for purposes of this Rule.

**[2848.] 2357. Communications with the Public and Customers Concerning Index Warrants, Currency Index Warrants[,] and Currency Warrants**

The provisions of NASD Rule 2220 shall be applicable to communications to customers regarding index warrants, currency index warrants, or currency warrants. The term “option” as used therein shall be deemed to include such warrants for purposes of this Rule and the term “The Options Clearing Corporation” shall be deemed to mean the issuer of such warrants. NASD Rule 2220(c)(5) and (d)(2)(C)(v) shall also not be applicable to communications with the public regarding index warrants, currency index warrants, or currency warrants.

**[2849.] 2358. Maintenance of Records**

The record-keeping provisions of Rule [2860] 2360(b)(17)(B) shall be applicable to customer accounts approved to trade index warrants, currency index warrants, or currency warrants. The term “option” as used therein shall be deemed to include such warrants for purposes of this Rule.

**[2850.] 2359. Position and Exercise Limits; Liquidations**

**(a) Position Limits**

Except with the prior written approval of [the Association] FINRA pursuant to the Rule 9600 Series for good cause shown, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, a purchase or sale transaction in an index warrant listed on a national securities exchange if the member has reason to believe that as a result of such transaction the member, or partner, officer, director or employee thereof, or customer would, acting alone or in concert with others, directly or indirectly,

hold or control an aggregate position in an index warrant issue on the same side of the market, combining such index warrant position with positions in index warrants overlying the same index on the same side of the market, in excess of the position limits established by the exchange on which the index warrant is listed.

**[2851.] (b) Exercise Limits**

[(a)] (1) Except with the prior written approval of [the Association] FINRA pursuant to the Rule 9600 Series for good cause shown, in each instance, no member or person associated with a member shall exercise, for any account in which such member or person associated with such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, a long position in any index warrant if as a result thereof such member or partner, officer, director or employee thereof or customer, acting alone or in concert with others, directly or indirectly, has or will have exceeded the applicable exercise limit fixed from time to time by an exchange for an index warrant.

[(b)] (2) [The Association] FINRA, pursuant to the Rule 9600 Series for good cause shown, may institute other limitations concerning the exercise of index warrants from time to time. Reasonable notice shall be given of each new limitation fixed by [the Association] FINRA. These exercise limitations are separate and distinct from any other exercise limitations imposed by the issuers of index warrants.

**[2852. Reserved]**

**[2853.] (c) Liquidations [of Index Warrant Positions]**

[(a)] (1) Whenever [the Association] FINRA determines that a person or group of persons acting in concert holds or controls an aggregate position (whether short or long) in index warrants overlying the same index in excess of the position limitations established by [Rule 2850]paragraph (a), it may, when deemed necessary or appropriate in the public interest and for the protection of investors, direct any member or all members carrying a position in index warrants overlying such index for such person or persons to liquidate such position or positions, or portions thereof, as expeditiously as possible and consistent with the maintenance of an orderly market, so as to bring such person or persons into compliance with the position limitations contained in [Rule 2850]paragraph (a).

[(b)] (2) Whenever such a directive is issued by [the Association] FINRA no member receiving notice thereof shall accept and/or execute for any person or persons named in such directive any order to purchase or sell short any index warrants based on the same index, unless in each instance express approval therefor is given by [the Association] FINRA, or the directive is rescinded.

**[2854. Reserved]**

**[2860.] 2360. Options**

[(a)] For purposes of this Rule, the term “option” shall mean any put, call, straddle or other option or privilege, which is a “security” as defined in Section 2(1) of the Securities Act of 1933, as amended, but shall not include any tender offer, registered warrant, right, convertible security or any other option in respect to which the writer is

the issuer of the security which may be purchased or sold upon the exercise of the option.]

**[(b) Requirements]**

**[(1) General]**

[(A) Applicability — This Rule shall be applicable (i) to the extent appropriate unless otherwise stated herein, to the conduct of accounts, the execution of transactions, and the handling of orders in exchange-listed options by members that are not members of an exchange on which the option executed is listed; (ii) to the extent appropriate unless otherwise stated herein, to the conduct of accounts, the execution of transactions, and the handling of orders in conventional options; and (iii) to other matters related to options trading.]

[Unless otherwise indicated herein, subparagraphs (3) through (12) shall apply only to standardized and conventional options on common stock and subparagraphs (13) through (24) shall apply to transactions in all options as defined in paragraph (a), including common stock. The position and exercise limits for FLEX Equity Options for members that are not also members of the exchange on which FLEX Equity Options trade shall be the same as the position and exercise limits as applicable to members of the exchange on which such FLEX Equity Options are traded.]

[(B) Except to the extent that specific provisions in this Rule govern, or unless the context otherwise requires, the provisions of the By-



Laws and Rules and all other interpretations and policies of the Board of Governors shall also be applicable to the trading of option contracts. ]

[(C) Local Time — All times are stated in this Rule in terms of the local time in effect in New York City (Eastern Time) or as otherwise specified.]

**[(2)](a) Definitions**

The following terms shall, unless the context otherwise requires, have the stated meanings:

[(A) Advertisement — The term “advertisement” means material published, or designed for use in, a newspaper, magazine or other periodical, radio, telephone or tape recording, motion picture, television, videotape display, signs or billboards, telephone directories (other than routine listings), or other public media.]

[(B) Aggregate Current Index Value — The term “aggregate current index value” means the value required to be delivered to the holder of a call or by the holder of a put (against payment of the aggregate exercise price) upon the valid exercise of an index option. Such value is equal to the index dollar equivalent on the trading day on which an exercise notice is properly tendered to The Options Clearing Corporation; or, if the day on which such notice is so tendered is not a trading day, then on the most recent trading day.]

[(C)](1) Aggregate Exercise Price — The term “aggregate exercise price” means the exercise price of an option contract multiplied by the number of units of the underlying security covered by such option contract.

[(D) Aggregate Index Option Exercise Price — The term “aggregate exercise price” in respect of an index option means the exercise price of such option times the index multiplier.]

[(E) Aggregate Long and Aggregate Short — The terms “aggregate long” or “aggregate short” mean a person’s total interest as the holder or writer of option contracts of a particular class of options.]

[(F) Beneficial Owner — The term “beneficial owner” means the person who has or shares the power to direct the voting or the disposition of securities, or who has or shares the right to receive or the power to direct the receipt of dividends or the proceeds from the sale of securities.]

[(G)](2) Call — The term “call” means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to purchase the number of units of the underlying security or to receive a dollar equivalent of the underlying index covered by the option contract. In the case of a “call” issued by The Options Clearing Corporation on common stock, it shall mean an option contract under which the holder of the option has the right, in accordance with the terms of the option, to purchase from The Options Clearing Corporation the number of units of the underlying security or receive a dollar equivalent of the underlying index covered by the option contract.

[(H)](3) Class of Options — The term “class of options” means all option contracts of the same type of option covering the same underlying security or index.

[(I)](4) Clearing Member — The term “clearing member” means a FINRA member [of the Association] which has been admitted to membership in The Options Clearing Corporation pursuant to the provisions of the rules of The Options Clearing Corporation.

[(J) Closing Purchase Transaction — The term “closing purchase transaction” means an option transaction in which the purchaser’s intention is to reduce or eliminate a short position in the series of options involved in such transaction.]

[(K)](5) Closing Sale Transaction — The term “closing sale transaction” means an option transaction in which the seller’s intention is to reduce or eliminate a long position in the series of options involved in such transaction.

[(L)](6) Control

[(i)](A) The term “control” means the power or ability of an individual or entity to make investment decisions for an account or accounts, or influence directly or indirectly the investment decisions of any person or entity who makes investment decisions for an account. In addition, control will be presumed in the following circumstances:

[a.](i) among all parties to a joint account who have authority to act on behalf of the account;

[b.](ii) among all general partners to a partnership account;

[c.](iii) when a person or entity:

[1.]a. holds an ownership interest of 10 percent or more in an entity (ownership interest of less than 10 percent will not preclude aggregation), or

[2.]b. shares in 10 percent or more of profits and/or losses of an account;

[d.](iv) when accounts have common directors or management;

[e.](v) where a person or entity has the authority to execute transactions in an account.

[(ii)](B) Control, presumed by one or more of the above powers, abilities or circumstances, can be rebutted by proving the factor does not exist or by showing other factors which negate the presumption of control. The rebuttal proof must be submitted by affidavit and/or such other evidence as may be appropriate in the circumstances.

[(iii)](C) [The Association] FINRA will also consider the following factors in determining if aggregation of accounts is required:

[a.](i) similar patterns of trading activity among separate entities;

[b.](ii) the sharing of kindred business purposes and interests;

[c.](iii) whether there is common supervision of the entities which extends beyond assuring adherence to each entity's investment objectives and/or restrictions;

[d.](iv) the degree of contact and communication between directors and/or managers of separate accounts.

[(M)](7) Controls, Is Controlled by or Is Under Common Control With — The terms “controls,” “is controlled by” and “is under common control with” shall have the meanings specified in [SEC] Rule 405 of SEC Regulation C [under the Securities Act of 1933].

[(N)](8) Conventional Index Option — The term “conventional index option” means any options contract not issued, or subject to issuance, by The Options Clearing Corporation that, as of the trade date, overlies a basket or index of securities that:

[(i)](A) Underlies a standardized index option; or

[(ii)](B) Satisfies the following criteria:

[a.](i) The basket or index comprises 9 or more equity securities;

[b.](ii) No equity security comprises more than 30% of the equity security component of the basket's or index's weighting;  
and

[c.](iii) Each equity security comprising the basket or index:

[1.]a. is a component security in either the Russell 3000 Index or the FTSE All-World Index Series; or

[2.]b. has

[(A)]1. market capitalization of at least \$75 million or, in the case of the lowest weighted component securities in the basket or index that in the aggregate account for no more than 10% of the weight of the index, \$50 million; and

[(B)]2. trading volume for each of the preceding six months of at least one million shares or, in the case of each of the lowest weighted component securities in the basket or index that in the aggregate account for no more than 10% of the weight of the index, 500,000 shares.

[(O)](9) Conventional Option — The term “conventional option” shall mean any option contract not issued, or subject to issuance, by The Options Clearing Corporation.

[(P)](10) Covered — The term “covered” in respect of a short position in a call option contract means that the writer’s obligation is secured by a “specific deposit” or an “escrow deposit,” meeting the conditions of Rules 610(e) or 610[(h)](g), respectively, of the rules of The Options Clearing Corporation, or the writer holds in the same account as the short position, on a unit-for-unit basis, a long position either in the underlying security or in an option contract of the same

class of options where the exercise price of the option contract in such long position is equal to or less than the exercise price of the option contract in such short position. The term “covered” in respect of a short position in a put option contract means that the writer holds in the same account as the short position, on a unit-for-unit basis, a long position in an option contract of the same class of options having an exercise price equal to or greater than the exercise price of the option contract in such short position.

[(Q) Current Index Value — The term “current index value” means the level of a particular index (derived from the current market prices of the underlying securities in the index group) at the close of trading on any trading day, or any multiple or fraction thereof specified by the Association as such value is reported by the reporting authority.]

[(R) Current Prospectus — The term “current prospectus” shall mean the edition of the prospectus of The Options Clearing Corporation as registered which at the time it is to be furnished to a given customer meets the requirements of Section 10(a)(3) of the Securities Act of 1933.]

[(S)](11) Delta Neutral — The term “delta neutral” describes an equity options position that has been fully hedged, in accordance with a Permitted Pricing Model as defined in paragraph (b)(3)(A)(vii)b. with a portfolio of instruments including or relating to the same underlying security to offset the risk that the value of the equity options position will change with incremental changes in the price of the security underlying the options position.

[(T)](12) Disclosure Document(s) — The term “disclosure document” or “disclosure documents” shall mean those documents filed with the SEC, prepared by one or more options markets and meeting the requirements of [SEC] SEA Rule 9b-1 [under the Act]. They shall contain general explanatory information relating to the mechanics of buying, writing and exercising options; the risks involved, the uses of and market for the options; transaction costs and applicable margin requirements; tax consequences of trading options; identification of the options issuer and the instrument underlying the options class; and the availability of the prospectus and the information in Part II of the registration statement.

[(U) Escrow Receipt — The term “escrow receipt” means a representation of an issuing bank to The Options Clearing Corporation that a particular customer’s securities are on deposit with the bank and will be delivered upon exercise of the option for which the receipt is issued.]

[(V)](13) Exercise Price — The term “exercise price” in respect of an option contract means the stated price per unit at which the underlying security may be purchased (in the case of a call) or sold (in the case of a put) upon the exercise of such option contract.

[(W)](14) Expiration Date — The term “expiration date” of an option contract issued by The Options Clearing Corporation means the day and time fixed by the rules of The Options Clearing Corporation for the expiration of all option contracts having the same expiration month as such option contract. The term “expiration date” of all other option contracts means the date specified thereon for such.



~~[(X)]~~(15) Expiration Month — The term “expiration month” in respect of an option contract means the month and year in which such option contract expires.

~~[(Y)]~~(16) FLEX Equity Option — The term “FLEX Equity Option” means any options contract issued, or subject to issuance by, The Options Clearing Corporation whereby the parties to the transaction have the ability to negotiate the terms of the contract consistent with the rules of the exchange on which the options contract is traded.

~~[(Z)]~~ Index Dollar Equivalent — The term “index dollar equivalent” is the dollar amount which results when the index value is multiplied by the appropriate index multiplier.]

~~[(AA)]~~ Index Group — The term “index group” means a group of securities whose inclusion and relative representation in the group is determined by the inclusion and relative representation of their current market values in a securities index specified by the Association.]

~~[(BB)]~~ Index Multiplier — The term “index multiplier” as used in reference to an index option contract means the dollar amount (as specified by the Association) by which the current index value is to be multiplied to obtain the aggregate index value. Such term replaces the term “unit of trading” used in reference to other kinds of options.]

~~[(CC)]~~ Index Option Exercise Price — The term “exercise price” in respect of an index option means the specified index value which, when multiplied by the index multiplier, will yield the aggregate exercise price

at which the aggregate current index value may be purchased (in the case of a call) or sold (in the case of a put) upon the exercise of such option.]

[(DD) Index Option Premium — The term “index option premium” means the price of each such option (expressed in points), as agreed upon by the purchaser and seller in such transaction, times the index multiplier and the number of options subject to the transaction.]

[(EE)](17) Long Position — The term “long position” means the number of outstanding option contracts of a given series of options held by a person (purchaser).

[(FF) Member and Person Associated with a Member — The terms “member” and “person associated with a member” shall have the meanings as specified in Article I of the By-Laws of the Association.]

[(GG)](18) Net Delta — The term “net delta” means the number of shares that must be maintained (either long or short) to offset the risk that the value of an equity options position will change with incremental changes in the price of the security underlying the options position.

[(HH) Opening Purchase Transaction — The term “opening purchase transaction” means an option transaction in which the purchaser’s intention is to create or increase a long position in the series of options involved in such transaction.]

[(II)](19) Opening Writing Transaction — The term “opening writing transaction” means an option transaction in which the seller’s (writer’s) intention

is to create or increase a short position in the series of options involved in such transaction.

(20) Option — The term “option” shall mean any put, call, straddle or other option or privilege, which is a “security” as defined in Section 2(1) of the Securities Act, as amended, but shall not include any (A) tender offer, (B) registered warrant, (C) right, (D) convertible security or (E) any other option in respect to which the writer (seller) is the issuer of the security which may be purchased or sold upon the exercise of the option.

~~[(JJ)]~~(21) Option Transaction — The term “option transaction” means a transaction effected by a member for the purchase or sale of an option contract, or for the closing out of a long or short position in such option.

~~[(KK)]~~(22) Options Contract — The term “options contract” means any option as defined in paragraph (a)(20). For purposes of [sub]paragraphs (b)(3) through (12), an option to purchase or sell common stock shall be deemed to cover 100 shares of such stock at the time the contract granting such option is written. If a stock option is granted covering some other number of shares, then for purposes of [sub]paragraphs (b)(3) through (12), it shall be deemed to constitute as many option contracts as that other number of shares divided by 100 (e.g., an option to buy or sell five hundred shares of common stock shall be considered as five option contracts). A stock option contract that, when written, grants the right to purchase or sell 100 shares of common stock shall continue to be considered as one contract throughout its life, notwithstanding that, pursuant to its terms, the number of shares that it covers may be adjusted to reflect stock

dividends, stock splits, reverse splits, or other similar actions by the issuer of such stock.

[(LL)](23) Options Contract Equivalent of the Net Delta — the term “options contract equivalent of the net delta” means the net delta divided by the number of shares underlying the options contract.

[(MM)](24) Options Trading — The term “options trading” means trading [(i)](A) in any option issued by The Options Clearing Corporation, and [(ii)](B) in any conventional option.

[(NN)](25) Outstanding — The term “outstanding” in respect of an option contract means an option contract which has neither been the subject of a closing sale transaction nor has been exercised nor reached its expiration date.

[(OO) Participating Organization — The term “participating organization” means a national securities exchange or association which has qualified for participation in The Options Clearing Corporation pursuant to the provisions of Article VII of the By-Laws of The Options Clearing Corporation.]

[(PP)](26) Premium — The term “premium” means the aggregate price of the option contracts agreed upon between the buyer and writer/seller or their agents.

[(QQ)](27) Put — The term “put” means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to sell the number of units of the underlying security or deliver a dollar equivalent of the underlying index covered by the option contract. In the case of a “put”

issued by The Options Clearing Corporation on common stock, it shall mean an option contract under which the holder of the option has the right, in accordance with terms of the option, to sell to The Options Clearing Corporation the number of units of the underlying security covered by the option contract or to tender the dollar equivalent of the underlying index.

[(RR)](28) Rules of The Options Clearing Corporation — The term “rules of The Options Clearing Corporation” means the by-laws and the rules of The Options Clearing Corporation, and all written interpretations thereof as may be in effect from time to time.

[(SS) Sales Literature — The term “sales literature” means any notice, circular, report (including research report), newsletter (including market letter), form letter or reprint or excerpt of the foregoing or of any published article, or any other promotional literature designed for use with the public which material does not meet the definition of “advertisement.” A form letter shall include one of a series of identical letters, or individually typed or prepared letters which contain essentially identical statements or repeat the same basic theme and which are sent to 25 or more persons.]

[(TT)](29) Series of Options — The term “series of options” means all option contracts of the same class of options having the same exercise price and expiration date and which cover the same number of units of the underlying security or index.

[(UU)](30) Short Position — The term “short position” means the number of outstanding option contracts of a given series of options with respect to which a person is obligated as a writer (seller).

[(VV) Spread Order — The term “spread order” means an order to buy a stated number of option contracts and to sell the same number of option contracts, or contracts representing the same number of units at option, of the same class of options.]

[(WW)](31) Standardized Equity Option — The term “standardized equity option” means any equity options contract issued, or subject to issuance by, The Options Clearing Corporation that is not a FLEX Equity Option.

[(XX)](32) Standardized Index Option — The term “standardized index option” means any options contract issued, or subject to issuance, by The Options Clearing Corporation that is based upon an index.

[(YY)](33) The Options Clearing Corporation — The term “The Options Clearing Corporation” means The Options Clearing Corporation[, the issuer of exchange listed options displayed on The Nasdaq Stock Market].

[(ZZ)](34) Type of Option — The term “type of option” means the classification of an option contract as either a put or a call.

[(AAA)](35) Uncovered — The term “uncovered” in respect of a short position in an option contract means the short position is not covered. For purposes of [sub]paragraph (b)(16) (Opening of Accounts), [sub]paragraph (b)(20) (Supervision of Accounts) and [sub]paragraph (b)(11) (Delivery of Current Disclosure Document(s)), the term “writing uncovered short option

positions” shall include combinations and any other transactions which involve uncovered writing.

[(BBB)](36) Underlying Index —The term “underlying index” means an index underlying a Standardized Index Option or a Conventional Index Option.

[(CCC)](37) Underlying Security — The term “underlying security” in respect of an option contract means the security which The Options Clearing Corporation or another person shall be obligated to sell (in the case of a call) or purchase (in the case of a put) upon the valid exercise of such option contract.

[(DDD)](38) Unit — The term “unit” shall mean the smallest interest in a particular security which can be purchased or sold, such as one share of stock, one warrant, one bond, and so forth.

**(b) Requirements**

**(1) Applicability**

This Rule shall be applicable to the extent appropriate unless otherwise stated herein: (A) to the conduct of accounts, the execution of transactions, and the handling of orders in exchange-listed options by members that are not members of an exchange on which the option executed is listed; (B) to the conduct of accounts, the execution of transactions, and the handling of orders in conventional options by all members; and (C) to other matters related to options trading.

Subparagraphs (3) through (12) shall apply only to standardized and conventional options on common stock. Subparagraphs (13) through (24) shall

apply to transactions in all options as defined in paragraph (a)(20), including common stock unless otherwise indicated herein.

**(2) FLEX Equity Options**

The position and exercise limits for FLEX Equity Options for members that are not also members of the exchange on which FLEX Equity Options trade shall be the same as the position and exercise limits as applicable to members of the exchange on which such FLEX Equity Options are traded.

**(3) Position Limits**

(A) Stock Options — Except in highly unusual circumstances, and with the prior written approval of [NASD] FINRA pursuant to the Rule 9600 Series for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, non-member broker, or non-member dealer, an opening transaction through the over-the-counter market or on any exchange in a stock option contract of any class of stock options if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or customer, non-member broker, or non-member dealer, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate equity options position in excess of:

(i) through (v) No Change.



(vi) such other number of stock option contracts as may be fixed from time to time by [NASD] FINRA as the position limit for one or more classes or series of options provided that reasonable notice shall be given of each new position limit fixed by [NASD] FINRA.

(vii) Equity Option Hedge Exemptions

a. No Change.

1. through 8. No Change.

b. Delta Hedging Exemption For Members and Non-Member Affiliates

An equity options position of a member or non-member affiliate in standardized and/or conventional equity options that is delta neutral under a Permitted Pricing Model shall be exempt from position limits under this [r]Rule. Any equity options position of such member or non-member affiliate that is not delta neutral shall be subject to position limits, subject to the availability of other options position limit exemptions. The number of options contracts attributable to a position that is not delta neutral shall be the options contract equivalent of the net delta.

1. Permitted Pricing Model shall mean:

A. No Change.

B. A pricing model maintained and used by a member subject to consolidated supervision by the [Commission] SEC pursuant to Appendix E of [Commission] SEA Rule 15c3-1, or by an affiliate that is part of such member's consolidated supervised holding company group, in accordance with its internal risk management control system and consistent with the requirements of Appendices E or G, as applicable, to [Commission] SEA Rule 15c3-1 and [Commission] SEA Rule 15c3-4 [under the Act], as amended from time to time, in connection with the calculation of risk-based deductions from capital or capital allowances for market risk thereunder, provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such member's consolidated supervised holding company group;

C. A pricing model maintained and used by a financial holding company ("FHC") or a company treated as an FHC under the Bank Holding Company Act [of 1956], or by an affiliate that is part of either such company's consolidated supervised holding company group, in accordance with its internal risk management control system and consistent with:

i. through ii. No Change.

D. A pricing model maintained and used by an OTC derivatives dealer registered with the [Commission] SEC pursuant to [SEC] SEA Rule 15c3-1(a)(5) in accordance with its internal risk management control system and consistent with the requirements of Appendix F to [SEC] SEA Rule 15c3-1 and [SEC] SEA Rule 15c3-4 [under the Act], as amended from time to time, in connection with the calculation of risk-based deductions from capital for market risk thereunder, provided that only such OTC derivatives dealer and

no other affiliated entity (including a member) may rely on this subparagraph D[.]; or

E. No Change.

2. Effect on Aggregation of Account

Positions

A. No Change.

B. Notwithstanding subparagraph b.2.A. of this Rule, the Net Delta of an options position held by an entity entitled to rely on this exemption, or by a separate and distinct trading unit of such entity, may be calculated without regard to positions in or relating to the security underlying the options positions held by an affiliated entity or by another trading unit within the same entity, provided that:

- i. the entity demonstrates to [NASD] FINRA's satisfaction that no control relationship, as discussed in Supplementary Material .02 [defined in Notice to Members 07-

03], exists between such affiliates or trading units;[\*] and

ii. the entity has provided [NASD] FINRA written notice in advance that it intends to be considered separate and distinct from any affiliate, or – as applicable – which trading units within the entity are to be considered separate and distinct from each other for purposes of this exemption.

[\* Note: NASD has set forth, in Notice to Members 07-03, the conditions under which it will deem no control relationship to exist between affiliates and between separate and distinct trading units within the same entity.]

C. Notwithstanding subparagraph b.2.A. or b.2.B. of this Rule, a member or non-member affiliate who relies on this exemption shall designate, by prior written notice to [NASD] FINRA, each trading unit

or entity whose options positions are required under [NASD] FINRA [R]rules to be aggregated with the option positions of such member or non-member affiliate that is relying on this exemption for purposes of compliance with [NASD] FINRA position limits or exercise limits. In any such case:

i. No Change.

ii. the net delta of the positions owned or controlled by the entities and trading units who are relying on this exemption shall be aggregated with the nonexempt option positions of all other entities and trading units whose options positions are required under [NASD] FINRA [R]rules to be aggregated with the option positions of such member or affiliate.

### 3. Obligations of Members and Affiliates

A member that relies, or whose affiliate relies, upon this exemption must provide a written certification to [NASD] FINRA that it and/or its

affiliates are using a Permitted Pricing Model pursuant to subparagraph 1. above and that if the affiliate ceases to hedge stock options positions in accordance with such Permitted Pricing Model, it will provide immediate written notice to the member.

The options positions of a non-member relying on this exemption must be carried by a member with which it is affiliated.

4. Reporting

A. No Change.

B. In addition, each member on its own behalf or on behalf of a designated aggregation unit pursuant to [sub]paragraph (b)(3)(A)(vii)b.2. shall report in a manner specified by [NASD] FINRA the options contract equivalent of the net delta of each position that represents 200 or more contracts (whether long or short) on the same side of the market covering the same underlying security that are effected by the member.

(viii) Conventional Equity Options

a. No Change.

b. In order for a security not subject to standardized equity options trading to qualify for an options position limit of more than 25,000 contracts, a member must first demonstrate to [NASD's] FINRA's Market Regulation Department that the underlying security meets the standards for such higher options position limit and the initial listing standards for standardized options trading.

Provided, however, that for certain securities in an index designated by [NASD] FINRA, a member may claim such higher position limit as permitted in accordance with the volume and float criteria specified by [NASD] FINRA; provided further, that a member claiming a higher position limit under this subparagraph must notify [NASD's] FINRA's Market Regulation Department in writing in such form as may be prescribed by [NASD] FINRA and shall be filed no later than the close of business day on the next business day following the day on which the transaction or transactions requiring such limits occurred; and provided further, that the member must agree to reduce its position in the event that [NASD] FINRA staff determines different position limits [should] shall apply.



(B) Index Options

Except in highly unusual circumstances, and with the prior written approval of [the Association] FINRA pursuant to the Rule 9600 Series for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, an opening transaction in an option contract of any class of index options dealt in on an exchange if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or customer, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate position in excess of position limits established by the exchange on which the option trades.

(C) No Change.

(D) [The Association] FINRA will notify the [Commission] SEC at any time it approves a request to exceed the limits established pursuant to paragraph (b)(3).

**(4) Exercise Limits**

Except in highly unusual circumstances, and with the prior written approval of [the Association] FINRA pursuant to the Rule 9600 Series for good cause shown in each instance, no member or person associated with a member shall exercise, for any account in which such member or person associated with a member has an interest, or for the account of any

partner, officer, director or employee thereof or for the account of any customer, non-member broker, or non-member dealer, any option contract if as a result thereof such member or partner, officer, director or employee thereof or customer, non-member broker, or non-member dealer, acting alone or in concert with others, directly or indirectly, has or will have exercised within any five (5) consecutive business days a number of option contracts of a particular class of options in excess of the limits for options positions in paragraph (b)(3). [The Association] FINRA may institute other limitations concerning the exercise of option contracts from time to time by action of [the Association] FINRA. Reasonable notice shall be given of each new limitation fixed by [the Association] FINRA.

**(5) Reporting of Options Positions**

(A)(i)a. Conventional Options

Each member shall file or cause to be filed with [NASD] FINRA a report with respect to each account in which the member has an interest, each account of a partner, officer, director or employee of [r] such member, and each customer, non-member broker, or non-member dealer account, which has established an aggregate position of 200 or more option contracts (whether long or short) of the put class and the call class on the same side of the market covering the same underlying security or index, combining for purposes of this subparagraph long positions

in put options with short positions in call options and short positions in put options with long positions in call options, provided, however, that such reporting with respect to positions in conventional index options shall apply only to an option that is based on an index that underlies, or is substantially similar to an index that underlies, a standardized index option.

b. Standardized Options

Each member that conducts a business in standardized options but is not a member of the options exchange upon which the standardized options are listed and traded shall file or cause to be filed with [the Association] FINRA a report with respect to each account in which the member has an interest, each account of a partner, officer, director or employee of such member, and each customer, non-member broker, or non-member dealer account, which has established an aggregate position of 200 or more option contracts (whether long or short) of the put class and the call class on the same side of the market covering the same underlying security or index, combining for purposes of this subparagraph long positions in put options with short positions in call options and short positions in put options with long positions in call options.

(ii) The reports required by this subparagraph shall identify the person or persons having an interest in such account and shall identify separately the total number of option contracts of each such class comprising the reportable position in such account. The reports shall be in such form as may be prescribed by [the Association] FINRA and shall be filed no later than the close of business on the next business day following the day on which the transaction or transactions requiring the filing of such report occurred. Whenever a report shall be required to be filed with respect to an account pursuant to this subparagraph, the member filing such shall file with [the Association] FINRA such additional periodic reports with respect to such account as [the Association] FINRA may from time to time prescribe.

(B) In addition to the reports required by subparagraph (A) above, each member shall report promptly to [the Association] FINRA any instance in which such member has a reason to believe that a person, acting alone or in concert with others, has exceeded or is attempting to exceed the position limits or the exercise limits set forth in [sub]paragraphs (b)(3) and (4).

**(6) Liquidation of Positions and Restrictions on Access**

(A) Whenever [the Association] FINRA determines that a person or group of persons acting in concert holds or controls, or is obligated in respect of, an aggregate position in option contracts covering any

underlying security or index in excess of the position limitations established by paragraph (b)(3), it may, when deemed necessary or appropriate in the public interest and for the protection of investors, direct:

(i) No Change.

(ii) that such person or persons named therein not be permitted to execute an opening transaction, and that no member shall accept and/or execute for any person or persons named in such directive, any order for an opening transaction in any option contract, unless in each instance express approval therefor is given by [the Association] FINRA, the directive is rescinded, or the directive specifies another restriction appropriate under the circumstances.

(B) Prior to the issuance of any directive provided for in subparagraph (A), [the Association] FINRA shall notify, in the most expeditious manner possible, such person, or group of persons of such action, the specific grounds therefor and provide them an opportunity to be heard thereon. In the absence of unusual circumstances, in the case of a directive pursuant to the provisions of subparagraph (A)(i) hereof, the hearing shall be held within one business day of notice. In the case of a directive pursuant to the provisions of subparagraph (A)(ii) hereof, the hearing shall be held as promptly as possible under the circumstances. In any such proceeding a record shall be kept. A determination by [the Association] FINRA after hearing or waiver of hearing, to implement such

directive shall be in writing and shall be supported by a statement setting forth the specific grounds on which the determination is based. Any person aggrieved by action taken by [the Association] FINRA pursuant to this subparagraph may make application for review to the [Commission] SEC in accordance with Section 19 of the Exchange Act.

**(7) Limit on Uncovered Short Positions**

Whenever [the Association] FINRA shall determine in light of current conditions in the markets for options, or in the markets for underlying securities, that there are outstanding a number of uncovered short positions in option contracts of a given class in excess of the limits established by [the Association] FINRA for purposes of this subparagraph or that a percentage of outstanding short positions in option contracts of a given class are uncovered, in excess of the limits established by [the Association] FINRA for purposes of this subparagraph, [the Association] FINRA, upon its determination that such action is in the public interest and necessary for the protection of investors and the maintenance of a fair and orderly market in the option contracts or underlying securities, may prohibit any further opening writing transactions in option contracts of that class unless the resulting short position will be covered, and it may prohibit the uncovering of any existing covered short position in option contracts of one or more series of options of that class.

**(8) Restrictions on Option Transactions and Exercises**

[The Association] FINRA may impose from time to time such restrictions on option transactions or the exercise of option contracts in one or more series of

options of any class which it determines are necessary in the interest of maintaining a fair and orderly market in option contracts, or in the underlying securities covered by such option contracts, or otherwise necessary in the public interest or for the protection of investors. During the period of any such restriction, no member shall effect any option transaction or exercise any option contract in contravention of such restriction. Notwithstanding the foregoing, during the ten (10) business days prior to the expiration date of a given series of options, no restriction established pursuant to this subparagraph on the exercise of option contracts shall remain in effect with respect to that series of options.

**(9) Rights and Obligations of Holders and Writers**

Subject to the provisions of [sub]paragraphs (b)(4), (6), and (8), the rights and obligations of holders and writers of option contracts of any class of options issued by The Options Clearing Corporation shall be set forth in the rules of The Options Clearing Corporation.

**(10) Open Orders on “Ex-Date”**

Open orders for one or more option contracts of any class of options issued by The Options Clearing Corporation held by members prior to the effective date of an adjustment by The Options Clearing Corporation to the terms of a class of options pursuant to Article VI, Section 11A of the By-Laws of The Options Clearing Corporation shall be adjusted on the “ex-date” by such amount as The Options Clearing Corporation shall specify, unless otherwise instructed by the customer.

**(11) Delivery of Current Disclosure Documents**

(A)(1) No Change.

(2) Special Statement for Uncovered Option Writers (“Special Written Statement”). In the case of customers approved for writing uncovered short options transactions, the Special Written Statement required by paragraph (b)(16) shall be in a format prescribed by [NASD] FINRA and delivered to customers in accordance with paragraph (b)(16). A copy of each new or revised Special Written Statement shall be distributed to each customer having an account approved for writing uncovered short options not later than the time a confirmation of a transaction is delivered to each customer who enters into a transaction in options issued by The Options Clearing Corporation.

(3) [NASD] FINRA will advise members when a new or revised current disclosure document meeting the requirements of [SEC] SEA Rule 9b-1 [of the Act] is available.

(B) Where a broker or dealer enters his orders with another member in a single omnibus account, the member holding the account shall take reasonable steps to assure that such broker or dealer is furnished reasonable quantities of current disclosure documents, as requested by him in order to enable him to comply with the requirements of [SEC] SEA Rule 9b-1 [of the Act].

(C) No Change.



**(12) Confirmations**

Every member shall promptly furnish to each customer a written confirmation of each transaction in option contracts for such customer's account. Each such confirmation shall show the type of option, the underlying security or index, the expiration month, the exercise price, the number of option contracts, the premium, the commission, the trade and settlement dates, whether the transaction was a purchase or a sale (writing) transaction, whether the transaction was an opening or a closing transaction, whether the transaction was effected on a principal or agency basis and, for other than options issued by The Options Clearing Corporation, the date of expiration. The confirmation shall by appropriate symbols distinguish between exchange listed and other transactions in option contracts though such confirmation does not need to specify the exchange or exchanges on which such options contracts were executed.

**(13) Transactions with Issuers**

No member [under any circumstances] shall enter a transaction for the sale (writing) of a call option contract for the account of any corporation which is the issuer of the underlying security thereof.

**(14) Restricted Stock**

For the purposes of covering a short position in a call option contract, delivery pursuant to the exercise of a put option contract, or satisfying an exercise notice assigned in respect of a call option contract, no member shall accept shares of an underlying stock, which may not be sold by the holder thereof except upon registration pursuant to the provisions of the Securities Act [of 1933] or pursuant

to [Commission] SEC rules promulgated under the Securities Act [of 1933], unless, at the time such securities are accepted and at any later time such securities are delivered, applicable provisions of the Securities Act [of 1933] and the rules thereunder have been complied with by the holder of such securities.

(15) No Change.

**(16) Opening of Accounts**

(A) No Change.

**(B) Diligence in Opening Accounts**

In approving a customer's account for options trading, a member or any person associated with a member shall exercise due diligence to ascertain the essential facts relative to the customer, his financial situation and investment objectives. Based upon such information, the branch office manager, [or other] a Registered Options Principal or a Limited Principal—General Securities Sales Supervisor shall specifically approve or disapprove in writing the customer's account for options trading; provided, that if the branch office manager is not a Registered Options Principal or a Limited Principal—General Securities Sales Supervisor, account approval or disapproval shall within ten (10) business days be submitted to and approved or disapproved by a Registered Options Principal or a Limited Principal—General Securities Sales Supervisor. [A record of the information obtained pursuant to this subparagraph and of the approval or disapproval of each such account shall be maintained by

the member as part of its permanent records in accordance with paragraph (b)(17).]

\* \* \* \* \*

**[IM-2860-2. Diligence in Opening Options Accounts]**

[(a) In fulfilling their obligations pursuant to Rule 2860(b)(16)(B), with](i) With respect to options customers who are natural persons, members shall seek to obtain the following information at a minimum (information shall be obtained for all participants in a joint account):

[(1)]a. Investment objectives (e.g., safety of principal, income, growth, trading profits, speculation);

[(2)]b. Employment status (name of employer, self-employed or retired);

[(3)]c. Estimated annual income from all sources;

[(4)]d. Estimated net worth (exclusive of family residence);

[(5)]e. Estimated liquid net worth (cash, securities, other);

[(6)]f. Marital status; number of dependents;

[(7)]g. Age; and[,]

[(8)]h. Investment experience and knowledge (e.g., number of years, size, frequency and type of transactions)

for options, stocks and bonds, commodities, and other[s]  
financial instruments.

[(b)](ii) In addition, a customer's account records shall contain the following information, if applicable:

[(1)]a. Source or sources of background and financial information (including estimates) concerning the customer;

[(2)]b. Discretionary authorization agreement on file, name, relationship to customer and experience of person holding trading authority;

[(3)]c. Date disclosure document(s) furnished to customer;

[(4)]d. Nature and types of transactions for which account is approved (e.g., buying covered writing, uncovered writing, spreading, discretionary transactions);

[(5)]e. Name of registered representative;

[(6)]f. Name of [ROP] Registered Options Principal or Limited Principal—General Securities Sales Supervisor approving account; date of approval; and

[(7)]g. Dates of verification of currency of account information.

[(c)](iii) Members [should] shall consider utilizing a standard account approval form so as to ensure the receipt of all the required information.

[(d)](iv) Refusal of a customer to provide any of the information called for in subparagraph [(a)](i) shall be so noted on the customer's records at the time the account is opened. Information provided shall be considered together with the other information available in determining whether and to what extent to approve the account for options trading.

[(e) The requirement of Rule 2860(b)(16)(C) for the initial and subsequent verification of customer background and financial information is to be satisfied by sending to the customer the information required in paragraph (a)(1) through (a)(6) hereof, as contained in the member's records and providing the customer with an opportunity to correct or complete the information. In all cases, absent advice from the customer to the contrary, the information will be deemed to be verified.]

\* \* \* \* \*

(v) A record of the information obtained pursuant to this subparagraph and of the approval or disapproval of each such account shall be maintained by the member as part of its permanent records in accordance with paragraph (b)(17).

**(C) Verification of Customer Background and Financial Information**

The background and financial information upon which the account of every new options customer that is a natural person has been approved for options trading, unless the information is included in the customer's account agreement, shall be sent to the customer for verification within fifteen (15) days after the customer's account has been approved for options trading. A copy of the background and financial information on file with a member shall also be sent to the customer for verification within fifteen (15) days after the member becomes aware of any material change in the customer's financial situation.

Members shall satisfy the initial and subsequent verification of customer background and financial information by sending to the customer the information required in subparagraphs (B)(i)a. through f. hereof, as contained in the member's records and providing the customer with an opportunity to correct or complete the information. In all cases, absent advice from the customer to the contrary, the information will be deemed to be verified.

**(D) Account Agreement**

Within fifteen (15) days after a customer's account has been approved for options trading, a member shall obtain from the customer a written agreement that the customer is aware of and agrees to be bound by [the] FINRA [R]rules [of the Association] applicable to the trading of

option contracts and, if he desires to engage in transactions in options issued by The Options Clearing Corporation, that the customer has received a copy of the current disclosure document(s) required to be furnished under this subparagraph (16) and that he is aware of and agrees to be bound by the rules of The Options Clearing Corporation. In addition, the customer [should] shall indicate on such written agreement that he is aware of and agrees not to violate the position limits established pursuant to paragraph (b)(3) and the exercise limits established pursuant to paragraph (b)(4).

**(E) Uncovered Short Option Contracts**

Each member transacting business with the public in writing uncovered short option contracts shall develop, implement and maintain specific written procedures governing the conduct of such business which shall include, at least, the following:

(i) through (ii) No Change.

(iii) Designation of a specific Registered Options [and Security Futures] Principal(s) as responsible for approving customer accounts that do not meet the specific criteria and standards for writing uncovered short option transactions and for maintaining written records of the reasons for every account so approved;

(iv) No Change.

(v) Requirements that customers approved for writing uncovered short options transactions be provided with a special written statement for uncovered option writers approved by [the Association] FINRA that describes the risks inherent in writing uncovered short option transactions, at or prior to the initial writing of an uncovered short option transaction.

**(17) Maintenance of Records**

(A) In addition to the requirements of NASD Rule 3110, every member shall maintain and keep current a separate central log, index or other file for all options-related complaints, through which these complaints can easily be identified and retrieved. The central file shall be located at the principal place of business of the member or such other principal office as shall be designated by the member. At a minimum, the central file shall include:

- (i) identification of complainant;
- (ii) date complaint was received;
- (iii) identification of registered representative servicing the account;
- (iv) a general description of the matter complained of; and
- (v) a record of what action, if any, has been taken by the member with respect to the complaint.

For purposes of this subparagraph, the term “options-related complaint” shall mean any written statement by a customer or person



acting on behalf of a customer alleging a grievance arising out of or in connection with options. Each options-related complaint received by a branch office of a member shall be forwarded to the office in which the separate, central file is located not later than 30 days after receipt by the branch office that is the subject of the complaint. A copy of every options-related complaint shall also be maintained at the branch office that is the subject of the complaint.

(B) No Change.

**(18) Discretionary Accounts**

**(A) Authorization and Approval**

(i) No member and no person associated with a member shall exercise any discretionary power with respect to trading in option contracts in a customer's account, or accept orders for option contracts for an account from a person other than the customer, except in compliance with the provisions of NASD Rule 2510 and unless:

a. The written authorization of the customer required by NASD Rule 2510 shall specifically authorize options trading in the account; and

b. No Change.

(ii) Each firm shall designate specific Registered Options [and Security Futures] Principals to review discretionary accounts. A Registered Options [and Security Futures] Principal other than

the Registered Options [and Security Futures] Principal who accepted the account shall review the acceptance of each discretionary account to determine that the Registered Options [and Security Futures] Principal accepting the account had a reasonable basis for believing that the customer was able to understand and bear the risk of the strategies or transactions proposed, and shall maintain a record of the basis for such determination. Every discretionary order shall be identified as discretionary on the order at the time of entry. Discretionary accounts shall receive frequent appropriate supervisory review by a Registered Options [and Security Futures] Principal who is not exercising the discretionary authority. The provisions of this subparagraph (18) shall not apply to discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite number of option contracts in a specified security shall be executed, except that the authority to exercise time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion, absent specific, written contrary indication signed and dated by the customer. This limitation shall not apply to time and price discretion exercised in an institutional account, as defined in NASD Rule 3110(c)(4), pursuant to valid Good-Till-

Cancelled instructions issued on a “not held” basis. Any exercise of time and price discretion must be reflected on the order ticket.

(iii) Any member that does not utilize computerized surveillance tools for the frequent and appropriate review of discretionary activity must establish and implement procedures to require specific Registered Options [and Security Futures] Principals who have been designated to review discretionary accounts to approve and initial each discretionary order on the day entered.

(B) through (C) No Change.

(19) No Change.

**(20) Supervision of Accounts**

**(A) Duty to Supervise**

Each member that conducts a public customer options business shall ensure that its written supervisory system policies and procedures pursuant to NASD Rules 3010, 3012, and 3013 adequately address the member’s public customer options business.

**(B) Branch Offices**

No branch office of a member shall transact an options business unless the principal supervisor of such branch office accepting options transactions has been qualified as either a Registered Options [and Security Futures] Principal or a Limited Principal—General Securities

Sales Supervisor; provided that this requirement shall not apply to branch offices in which no more than three registered representatives are located, so long as the options activities of such branch offices are appropriately supervised by either a Registered Options [and Security Futures] Principal or a Limited Principal—General Securities Sales Supervisor.

(C) No Change.

**(21) Violation of By-Laws and Rules of FINRA [the Association] or The Options Clearing Corporation**

(A) In [Association] FINRA disciplinary proceedings, a finding of violation of any provision of the rules, regulations or by-laws of The Options Clearing Corporation by any member or person associated with a member engaged in transactions involving options issued, or subject to issuance, by The Options Clearing Corporation, may be deemed to be conduct inconsistent with just and equitable principles of trade and a violation of NASD Rule 2110.

(B) In [Association] FINRA disciplinary proceedings, a finding of violation of any provision of the FINRA [R]rules, regulations or By-Laws [of the Association] by any member engaged in option transactions may be deemed to be conduct inconsistent with just and equitable principles of trade and a violation of NASD Rule 2110.

(22) No Change.

**(23) Tendering Procedures for Exercise of Options**

**(A) Exercise of Options Contracts**

(i) Subject to the restrictions established pursuant to paragraphs (b)(4) and (b)(8) hereof and such other restrictions that may be imposed by [NASD] FINRA, The Options Clearing Corporation or an options exchange pursuant to appropriate rules, an outstanding option contract issued by The Options Clearing Corporation may be exercised during the time period specified in the rules of The Options Clearing Corporation by the tender to The Options Clearing Corporation of an exercise notice in accordance with rules of The Options Clearing Corporation. An exercise notice may be tendered to The Options Clearing Corporation only by the clearing member in whose account the option contract is carried. Members may establish fixed procedures as to the latest time they will accept exercise instructions from customers.

(ii) Final exercise decisions of options holders to either exercise or not to exercise an expiring standardized equity option must be indicated to an options exchange that is a national securities exchange (national options exchange) that lists and trades the option, either directly to such national options exchange or via a member of such national options exchange if it is not a member of such exchange, by the respective member no later than 5:30 p.m. Eastern time (“ET”) on the business day immediately prior to the expiration date. For customer accounts, members may

not accept exercise instructions after 5:30 p.m. ET but have until 6:30 p.m. ET to submit a Contrary Exercise Advice (as defined below). For non-customer accounts, members may not accept exercise instructions after 5:30 p.m. ET but have until 6:30 p.m. ET to submit a Contrary Exercise Advice if such member employs an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Members are required to submit a Contrary Exercise Advice by 5:30 p.m. ET for non-customer accounts if such members do not employ an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Each member shall establish fixed procedures to ensure secure time stamps in connection with their electronic systems employed for the recording of submissions to exercise or not exercise expiring options. For purposes of this Rule [2860] 2360(b)(23)(A), the terms “customer account” and non-customer account” shall have the meanings as defined in The Options Clearing Corporation By-laws.

(iii) Special procedures apply to the exercise of standardized equity options on the last business day before their expiration (“expiring options”). Unless waived by The Options Clearing Corporation, expiring standardized equity options are subject to the Exercise-by-Exception (“Ex-by-Ex”) procedure

under The Options Clearing Corporation Rule 805. This [r]Rule provides that, unless contrary instructions are given, standardized equity option contracts that are in-the-money by specified amounts shall be automatically exercised. In addition to The Options Clearing Corporation rules, the following [NASD] FINRA requirements apply with respect to expiring standardized equity options. Option holders desiring to exercise or not exercise expiring standardized equity options must either:

a. No Change.

b. submit a “Contrary Exercise Advice” by the deadline specified in subparagraph (ii) above. A Contrary Exercise Advice is a form approved by the national options exchanges, [NASD] FINRA or The Options Clearing Corporation for use by a member to submit a final exercise decision committing an options holder to either: (1) not exercise an option position which would automatically be exercised pursuant to The Options Clearing Corporation’s Ex-by-Ex procedure; or (2) to exercise a standardized equity option position which would not automatically be exercised pursuant to The Options Clearing Corporation’s Ex-by-Ex procedure. A Contrary Exercise Advice may be canceled by filing an “Advice Cancel” or resubmitted at any time up to the submission cut-off times specified in

subparagraph (ii) above. Contrary Exercise Advices and/or Advice Cancels may be submitted by any member to:

1. through 4. No Change.

(iv) In those instances when The Options Clearing Corporation has waived the Ex-by-Ex procedure for an options class, members must either:

a. submit to any of the places listed in subparagraphs (iii)b.1. through 4. above, a Contrary Exercise Advice, within the time limits specified in subparagraph (ii) above if the holder intends to exercise the standardized equity option, or

b. No Change.

(v) Members that maintain proprietary or public customer positions in expiring standardized equity options shall take necessary steps to ensure that final exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. Members that have accepted the responsibility to indicate final exercise decisions on behalf of another member also shall take necessary steps to ensure that such decisions are properly indicated to the relevant national options exchange. Members may establish a processing cut-off time prior to [NASD's] FINRA's exercise cut-off time at which they will no longer accept final



exercise decisions in expiring standardized equity options from customers.

(vi) No Change.

(vii) In the event a national options exchange or The Options Clearing Corporation provides advance notice on or before 5:30 p.m. ET on the business day immediately prior to the last business day before the expiration date indicating that a modified time for the close of trading in standardized equity options on such last business day before expiration will occur, then the deadline to make a final decision to exercise or not exercise an expiring option shall be 1 hour 28 minutes following the time announced for the close of trading on that day instead of the 5:30 p.m. ET deadline found in subparagraph (ii) above. However, members may deliver a Contrary Exercise Advice or Advice Cancel to the places specified in subparagraphs (iii)b.1. through 4. above within 2 hours 28 minutes following the time announced for the close of trading in standardized equity options on that day instead of the 6:30 p.m. ET deadline found in subparagraph (ii) above for customer accounts and non-customer accounts where such member firm employs an electronic submission procedure with time stamp for the submission of exercise instructions. For non-customer accounts, members that do not employ an electronic procedure with time stamp for the submission of exercise instructions are

required to deliver a Contrary Exercise Advice or Advice Cancel within 1 hour and 28 minutes following the time announced for the close of trading on that day instead of the 5:30 p.m. ET deadline found in subparagraph (ii) above.

(viii) The filing of a final exercise decision, exercise instruction, exercise advice, Contrary Exercise Advice or Advice Cancel required by subparagraph (A) hereof does not serve as a substitute to the effective notice required to be submitted to The Options Clearing Corporation for the exercise or non-exercise of expiring standardized equity options.

(ix) No Change.

(x) The exercise cut-off requirements contained in this subparagraph (A) do not apply to any currency option or standardized index option products listed on a national options exchange.

(B) In the event a member receives and acts on an exercise instruction (for its own proprietary account or on behalf of a customer's account) pursuant to an exception set forth in subparagraphs a., b., or c. of subparagraph (A)(vi) hereof, the member shall maintain a memorandum setting forth the circumstances giving rise to such exception and shall file a copy of the memorandum with the Market Regulation Department of the national options exchange trading the option, if it is a member of such exchange, or [NASD's] FINRA's Market Regulation Department if it is

not a member of such exchange, no later than 12:00 p.m.[,] ET, on the business day following that expiration. Such memorandum must additionally include the time when such final exercise decision was made or, in the case of a customer, received, and shall be subject to the requirements of [SEC] SEA Rules 17a-3(a)(6) and 17a-4(b).

**(C) Allocation of Exercise Assignment Notices.**

(i) Each member shall establish fixed procedures for the allocation to customers of exercise notices assigned in respect of a short position in option contracts in such member's customer accounts. Such allocation shall be on a "first in-first out" or automated random selection basis that has been approved by [the Association] FINRA or on a manual random selection basis that has been specified by [the Association] FINRA. Each member shall inform its customers in writing of the method it uses to allocate exercise notices to its customer's accounts, explaining its manner of operation and the consequences of that system.

(ii) Each member shall report its proposed method of allocation to [the Association] FINRA and obtain [the Association's] FINRA's prior approval thereof, and no member shall change its method of allocation unless the change has been reported to and been approved by [the Association] FINRA. The requirements of this subparagraph (C) shall not be applicable to allocation procedures submitted to and approved by another self-

regulatory organization having comparable standards pertaining to methods of allocation.

(iii) No Change.

**(D) Delivery and Payment**

Delivery of the shares of an underlying security upon the exercise of an option contract and payment of the aggregate exercise price in respect thereto, shall be effected in accordance with the rules of The Options Clearing Corporation. As promptly as practicable after the exercise of an option contract by a customer, the member shall require the customer to make full cash payment of the aggregate exercise price in the case of a call option contract or to deposit the underlying stock in the case of a put option contract, or, in either case, to make the required margin deposit in respect thereto if such transaction is effected in a margin account, in accordance with the applicable regulations of the Federal Reserve Board and NASD Rule 2520. As promptly as practicable after the assignment to a customer of an exercise notice, the member shall require the customer to deposit the underlying stock in the case of a call option contract if the shares of the underlying security are not carried in the customer's account, or to make full cash payment of the aggregate exercise price in the case of a put option contract, or, in either case, to make the required market deposit in respect thereof, if such transaction is effected in a margin account, in accordance with NASD Rule 2520 and the applicable regulations of the Federal Reserve Board.

**(24) Options Transactions and Reports by Market Makers in Listed Securities**

Every member who is an off-board market maker in a security listed on a national securities exchange shall report to [the Association] FINRA in accordance with such procedures as may be prescribed by the Board of Governors, transactions involving 50 or more option contracts on such listed securities which are either directly for the benefit of (A) the member or (B) any employee, partner, officer, or director of the member who, by virtue of his position with the member, is directly involved in the purchase or sale of the underlying security for the firm's proprietary account(s) or is directly responsible for supervision of such persons; or who by virtue of his position in the firm, is authorized to, and regularly does, obtain information on the proprietary account(s) of the member in which the underlying security is traded. This subparagraph shall apply to all options transactions including those executed on an exchange to which the member may belong.

**(c) Portfolio Margining Disclosure Statement and Acknowledgement**

The special written disclosure statement describing the nature and risks of portfolio margining, and acknowledgement for an eligible participant signature, required by NASD Rule 2520(g)(5)(C) shall be in a format prescribed by [NASD] FINRA or in a format developed by the member, provided it contains substantially similar information as in the prescribed [NASD] FINRA format and has received the prior written approval of [NASD] FINRA.

**••• Supplementary Material: -----**

**[IM-2860-1. Position Limits]**

**.01 Position Limit Examples**

The following examples illustrate the operation of position limits established by [NASD] Rule [2860] 2360(b)(3) (all examples assume a position limit of 25,000 contracts and that the options are standardized options):

(a) Customer A, who is long 25,000 XYZ calls, may at the same time be short 25,000 XYZ calls, since long and short positions in the same class of options (i.e., in calls only, or in puts only) are on opposite sides of the market and are not aggregated for purposes of paragraph (b)(3).

(b) Customer B, who is long 25,000 XYZ calls, may at the same time be long 25,000 XYZ puts. Paragraph (b)(3) does not require the aggregation of long call and long put (or short call and short put) positions, since they are on opposite sides of the market.

(c) Customer C, who is long 20,000 XYZ calls, may not at the same time be short more than 5,000 XYZ puts, since the 25,000 contract limit applies to the aggregation of long call and short put positions in options covering the same underlying security. Similarly, if Customer C is also short 20,000 XYZ calls, he may not at the same time be long more than 5,000 puts, since the 25,000 contract limit applies separately to the aggregation of short call and long put positions in options covering the same underlying security.

(d) Customer D, who is short 2,000,000 shares of XYZ, may be long up to 45,000 XYZ calls, since the “hedge” exemption contained in paragraph (b)(3)(A)(vii) permits Customer D to establish an options position up to 25,000 contracts in size. In this instance 25,000 of the 45,000 contracts are permissible under the basic position limit

contained in paragraph (b)(3)(A)(i) and the remaining 20,000 contracts are permissible because they are hedged by the 2,000,000 short stock position.

.02 In connection with the delta hedging exemptions for members and non-member affiliates in Rule 2360(b)(3)(A)(vii)b., FINRA will require broker-dealer(s) to satisfy the following conditions in order for FINRA to deem no control relationship, in accordance with Rule 2360(a)(6), to exist between affiliates and between separate and distinct trading units within the same entity:

- operate the trading unit(s) requesting non-aggregation treatment independently of other trading units controlled by the broker-dealer, and disclose to FINRA the trading objective of the trading unit(s) requesting non-aggregation treatment;
- create internal firewalls and information barriers to segregate the trading unit(s) receiving non-aggregation treatment from other trading units controlled by the broker-dealer to prevent the flow of information (e.g., trades, positions, trading strategies);
- conduct all trading activity of the trading unit(s) requesting non-aggregation in a segregated account, which shall be reported to FINRA as such;
- maintain regulatory compliance oversight and internal controls and procedures addressing the non-aggregation arrangement;
- retain written records of information concerning the non-aggregated account, including, but not limited to, trading personnel, names of personnel making trading decisions, unusual trading activities, disciplinary action resulting from a breach of the broker-dealer's systems firewalls and information-sharing

policies, and the transfer of securities between the broker-dealer's non-aggregated accounts, which information shall be promptly made available to FINRA upon its request;

- promptly provide to FINRA a written report at such time there is any material change with respect to the non-aggregated account, which FINRA will use as a basis to reexamine its determination of non-aggregation; and
- provide a written acknowledgement that FINRA reserves the right to (1) impose additional restrictions and conditions with respect to the granting and removal of non-aggregation, and (2) freeze any position above the applicable position limit if FINRA determines that aggregation has become necessary due to changed circumstances.

Generally, the presumption of control in these types of arrangements will become easier to rebut as the physical separation between the trading units increases. For example, FINRA will require that trading units located on the same floor of a building be physically isolated from each other to ensure that no inappropriate communication will take place between individuals staffed in the applicable trading units.

**[2865.] 2370. Security Futures**

(a) For purposes of this Rule, the term “security future” shall have the definition specified in Section 3(a)(55) of the Exchange Act.

**(b) Requirements**

**(1) General**

(A) No Change.



(B) Subp[P]aragraph[s (12) and ](15) shall apply only to security futures carried in securities accounts.

(C) Except to the extent that specific provisions in this Rule govern, or unless the context otherwise requires, the provisions of the FINRA By-Laws and [R]rules and all other interpretations and policies of the Board of Governors shall also be applicable to the trading of security futures.

**(2) Definitions**

(A) The terms [“Beneficial Owner,”] “Control,” and “Controls,” “Is Controlled by” or “Is Under Common Control With” shall have the same meanings as in Rule [2860] 2360.

(B) The term “principal qualified to supervise security futures activities” means a Registered Options [and Security Futures] Principal who, consistent with NASD Rule 1022, has either completed a firm-element continuing education requirement that addresses security futures and a principal’s responsibilities for security futures or has passed a revised qualification examination for Registered Options [and Security Futures] Principals that covers security futures, or a Limited Principal-General Securities Sales Supervisor who, consistent with NASD Rule 1022, has either completed a firm-element continuing education requirement that addresses security futures and a principal’s responsibilities for security futures or has passed a revised qualification examination for Limited Principal-[-]General Securities Sales Supervisor.

(3) through (7) No Change.

**(8) Restrictions on Security Futures Transactions**

[The Association] FINRA may impose from time to time such restrictions on security futures transactions that it determines are necessary in the interest of maintaining a fair and orderly market in security futures, or in the underlying securities covered by such security futures, or otherwise necessary in the public interest or for the protection of investors. During the period of any such restriction, no member shall effect any security futures transaction in contravention of such restriction.

(9) through (10) No Change.

**(11) Delivery of Security Futures Risk Disclosure Statement**

(A) Every member shall deliver the current security futures risk disclosure statement to each customer at or prior to the time such customer's account is approved for trading security futures. Thereafter, each new or revised security futures risk disclosure statement shall be distributed to every customer having an account approved for such trading or, in the alternative, shall be distributed not later than the time a confirmation of a transaction is delivered to each customer who enters into a security futures transaction. [The Association] FINRA will advise members when a new or revised current security futures risk disclosure statement is available.

(B) through (C) No Change.

(12) through (15) No Change.

**(16) Opening of Accounts**

(A) No Change.

**(B) Diligence in Opening Accounts**

In approving a customer's account for security futures trading, a member or any person associated with a member shall exercise due diligence to ascertain the essential facts relative to the customer, the customer's financial situation and investment objectives. Members shall establish specific minimum net equity requirements for initial approval and maintenance of customers' security futures accounts. Based upon such information, a principal qualified to supervise security futures activities shall specifically approve or disapprove in writing the customer's account for security futures trading. For account approvals, the written record shall include the reasons for approval.

(i) With respect to security futures customers who are natural persons, members shall seek to obtain the following information at a minimum (information shall be obtained for all participants in a joint account):

a. through f. No Change.

g. Age; and[,]

h. No Change.

**(C) Verification of Customer Background and Financial Information**

For every natural person whose account has been approved for security futures trading, the background and financial information upon which the account was approved shall be sent to the customer for verification within fifteen (15) days after the customer's account has been approved for security futures trading. This verification requirement shall not apply if the background and financial information is included in the customer's account agreement or if the member has previously verified the customer's information in connection with an options account. A copy of the background and financial information on file with a member also shall be sent to the customer for verification within fifteen (15) days after the member becomes aware of any material change in the customer's financial situation.

Members shall satisfy the initial and subsequent verification of customer background and financial information by sending to the customer the information required in subparagraphs (B)(i)(a) through (i)(f) hereof, as contained in the member's records and providing the customer with an opportunity to correct or complete the information. In all cases, absent advice from the customer to the contrary, the information will be deemed to be verified.

**(D) Account Agreement**

Within fifteen (15) days after a customer's account has been approved for security futures trading, a member shall obtain from the customer a written agreement that the customer is aware of and agrees to

be bound by [the] FINRA [R]rules [of the Association] applicable to the trading of security futures and, that the customer has received a copy of the current security futures risk disclosure statement. In addition, the customer [should] shall indicate on such written agreement that the customer is aware of and agrees not to violate applicable security futures position limits.

**(17) Maintenance of Records**

(A) In addition to the requirements of NASD Rule 3110, every member shall maintain and keep current a separate central log, index, or other file for all security futures-related complaints, through which these complaints can easily be identified and retrieved. The central file shall be located at the principal place of business of the member or such other principal office as shall be designated by the member. At a minimum, the central file shall include:

- (i) identification of complainant;
- (ii) date complaint was received;
- (iii) identification of registered representative servicing the account;
- (iv) a general description of the matter complained of; and
- (v) a record of what action, if any, has been taken by the member with respect to the complaint.

For purposes of this subparagraph, the term “security futures-related complaint” shall mean any written statement by a customer or

person acting on behalf of a customer alleging a grievance arising out of or in connection with security futures. Each security futures-related complaint received by a branch office of a member shall be forwarded to the office in which the separate, central file is located not later than 30 days after receipt by the branch office that is the subject of the complaint. A copy of every security futures-related complaint shall also be maintained at the branch office that is the subject of the complaint.

(B) No Change.

**(18) Discretionary Accounts**

**(A) Authorization and Approval**

(i) No member or person associated with a member shall exercise any discretionary power with respect to trading in security futures in a customer's account, or accept orders for security futures for an account from a person other than the customer, except in compliance with the provisions of NASD Rule 2510 and unless:

a. The written authorization of the customer required by NASD Rule 2510 shall specifically authorize security futures trading in the account; and

b. No Change.

(ii) When analyzing an account to determine if it should be approved for security futures trading, each firm shall designate specific principals qualified to supervise security futures activities

to review discretionary accounts. A principal other than the principal who accepted the account [a principal qualified to supervise security futures activities] shall have a reasonable basis for believing that the customer was able to understand and bear the risk of the strategies or transactions proposed, and shall maintain a record of the basis for such determination. [Each discretionary order shall be approved and initialed on the day entered by the branch office manager or other principal qualified to supervise security futures activities, provided that if the branch officer is not a principal qualified to supervise security futures activities, such approval shall be confirmed within a reasonable time by a principal qualified to supervise security futures activities. Each] Every discretionary order shall be identified as discretionary on the order at the time of entry. Discretionary accounts shall receive frequent appropriate supervisory review by a principal qualified to supervise security futures activities who is not exercising the discretionary authority. The provisions of this subparagraph (18) shall not apply to discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite number of security futures contracts in a specified security shall be executed, except that the authority to exercise time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion,

absent specific, written contrary indication signed and dated by the customer. This limitation shall not apply to time and price discretion exercised in an institutional account, as defined in NASD Rule 3110(c)(4), pursuant to valid Good-Till-Cancelled instructions issued on a “not held” basis. Any exercise of time and price discretion must be reflected on the order ticket.

(iii) Any member that does not utilize computerized surveillance tools for the frequent and appropriate review of discretionary activity must establish and implement procedures to require specific principals qualified to supervise security futures activities who have been designated to review discretionary accounts to approve and initial each discretionary order on the day entered.

(B) through (C) No Change.

(19) through (20) No Change.

**(21) Violation of By-Laws and Rules of FINRA [the Association] or a Registered Clearing Agency**

(A) In [Association] FINRA disciplinary proceedings, a finding of violation of any provision of the rules, regulations, or by-laws of a registered clearing agency under Section 17A(b)(8) of the Exchange Act by any member or person associated with a member engaged in security futures transactions cleared by such registered clearing agency, may be



deemed to be conduct inconsistent with just and equitable principles of trade and a violation of NASD Rule 2110.

(B) In [Association] FINRA disciplinary proceedings, a finding of violation of any provision of the FINRA [R]rules, regulations or By-Laws [of the Association] by any member or person associated with a member engaged in security futures transactions may be deemed to be conduct inconsistent with just and equitable principles of trade and a violation of NASD Rule 2110.

(22) through (23) No Change.

**(24) Security Futures Transactions and Reports by Market Makers in Listed Securities**

Every member that is an off-board market maker in a security listed on a national securities exchange shall report to [the Association] FINRA in accordance with such procedures as may be prescribed by the Board of Governors, transactions involving 50 or more security futures contracts on such listed securities that are either directly for the benefit of (A) the member or (B) any employee, partner, officer, or director of the member who, by virtue of his or her position with the member, is directly involved in the purchase or sale of the underlying security for the firm's proprietary account(s) or is directly responsible for supervision of such persons; or who by virtue of his or her position in the firm, is authorized to, and regularly does, obtain information on the proprietary account(s) of the member in which the underlying security is traded. This

subparagraph shall apply to all security futures transactions including those executed on an exchange to which the member may belong.

**(25) Trading Ahead of Customer Orders**

Every member shall exercise due care to avoid trading ahead of a customer's security futures order. A member must exercise the due care required by this subparagraph[section] when the member has gained knowledge of or reasonably should have gained knowledge of the customer's order prior to the transmission to a securities exchange of the member's order for a proprietary account, or for any account in which it or any person associated with it is directly or indirectly interested.

\* \* \* \* \*

**Text of Incorporated NYSE Rule to Be Deleted  
In Their Entirety from the Transitional Rulebook.**

**Incorporated NYSE Rules**

\* \* \* \* \*

**[Rule 414. Index and Currency Warrants]**

Entire text deleted.

\* \* \* \* \*

**[Rule 424. Reports of Options]**

Entire text deleted.

\* \* \* \* \*

**[Option Rules (Rules 700—794)]**

**[Rule 700. Applicability, Definitions and References]**

Entire text deleted.

**[Rule 704. Position Limits]**

Entire text deleted.

**[Rule 705. Exercise Limits]**

Entire text deleted.

**[Rule 707. Liquidation of Positions]**

Entire text deleted.

**[Rule 709. Other Restrictions on Exchange Option Transactions and Exercises]**

Entire text deleted.

**[Rule 720. Registration of Options Principals]**

Entire text deleted.

**[Rule 721. Opening of Accounts]**

Entire text deleted.

**[Rule 722. Supervision of Accounts]**

Entire text deleted.

**[Rule 723. Suitability]**

Entire text deleted.

**[Rule 724. Discretionary Accounts]**

Entire text deleted.

**[Rule 725. Confirmations]**

Entire text deleted.

**[Rule 726. Delivery of Options Disclosure Document and Prospectus]**

Entire text deleted.

**[Rule 727. Transactions with Issuers]**

Entire text deleted.

**[Rule 728. Restricted Stock]**

Entire text deleted.

**[Rule 730. Statement of Accounts]**

Entire text deleted.

**[Rule 732. Customer Complaints]**

Entire text deleted.

**[Rule 780. Exercise of Option Contracts]**

Entire text deleted.

**[Rule 781. Allocation of Exercise Assignment Notices]**

Entire text deleted.

**[Rule 791. Communications to Customers]**

Entire text deleted.