

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * <input type="text" value="79"/>	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - <input type="text" value="2020"/> - * <input type="text" value="025"/>	Amendment No. (req. for Amendments *) <input type="text"/>
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Filing 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 type="checkbox"/>	Section 19(b)(3)(A) * <input checked="" type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
			Rule		
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	<input type="checkbox"/> 19b-4(f)(5)
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(6)	
			<input type="checkbox"/> 19b-4(f)(3)	<input checked="" type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 806(e)(1) * <input type="checkbox"/>	Section 806(e)(2) * <input type="checkbox"/>
Section 3C(b)(2) * <input type="checkbox"/>	

Exhibit 2 Sent As Paper Document <input checked="" type="checkbox"/>	Exhibit 3 Sent As Paper Document <input checked="" type="checkbox"/>
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Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed Rule Change to Amend Security Futures Risk Disclosure Statement

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 action.

First Name * <input type="text" value="Nicholas"/>	Last Name * <input type="text" value="Vitalo"/>
Title * <input type="text" value="Principal Counsel"/>	
E-mail * <input type="text" value="Nicholas.vitalo@finra.org"/>	
Telephone * <input type="text" value="(646) 315-8474"/>	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.

(Title *)

Date <input type="text" value="08/14/2020"/>	<input type="text" value="Senior Vice President and Deputy General Counsel"/>
By <input type="text" value="Patrice Gliniecki"/>	<input type="text" value="Patrice Gliniecki"/>

(Name *)

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 EFFF 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 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies *

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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, security-based swap submission, or advance notice 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

Add Remove View

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 the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act,” “SEA,” or “Exchange Act”),¹ Financial Industry Regulatory Authority, Inc. (“FINRA”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend: (1) Section 8.2 (Position Limits and Large Trader Reporting) of the Security Futures Risk Disclosure Statement (“2018 Statement” or “Statement”) to reflect the higher position limits for security futures contracts and changes to the large trader reporting timeframe adopted by the Commodity Futures Trading Commission (“CFTC”);² (2) Section 2.7 (Trading Halts) of the 2018 Statement to reflect the updated market-wide circuit breaker benchmark and thresholds approved by the SEC;³ and (3) the introductory section of the 2018 Statement to reflect that exchanges may now list security futures on certain debt instruments. FINRA is not proposing any textual changes to FINRA rules. The National Futures Association (“NFA”) has proposed parallel amendments to the Statement for its members.⁴

The proposed updated Statement (the “2020 Statement”), reflecting all cumulative updates, is attached as Exhibit 3a. The proposed supplement pertaining to changes to the

¹ 15 U.S.C. 78s(b)(1).

² See Position Limits and Position Accountability for Security Futures Products, 84 FR 51005 (September 27, 2019) (amending CFTC Regulation 41.25); see also Ownership and Control Reports, Forms 102/102S, 40/40S, and 71, 78 FR 69178 (November 18, 2013) (amending CFTC Rule 17.02, among others).

³ See Securities Exchange Act Release No. 67090 (May 31, 2012), 77 FR 33531 (June 6, 2012) (Order Approving File No. SR-FINRA-2011-054).

⁴ See Letter from Carol A. Wooding, NFA’s Senior Vice President and General Counsel, to Christopher J. Kirkpatrick, Office of the Secretariat, CFTC, dated May 29, 2020.

specified paragraphs under Sections 8.2 and 2.7, and the Introduction, as described herein (the “2020 Supplement”) is attached as Exhibit 3b.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The Chief Legal Officer of FINRA authorized the filing of the proposed rule change with the SEC pursuant to delegated authority. No other action by FINRA is necessary for the filing of the proposed rule change.

FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing so that FINRA can implement the proposed rule change in coordination with the parallel changes that the NFA has proposed to the Statement for its members.⁵ FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 30 days following Commission notice of the filing of the proposed rule change for immediate effectiveness.

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

(a) Purpose

Background

Subparagraph (A) under Rule 2370(b)(11) (Delivery of Security Futures Risk Disclosure Statement) requires a member to deliver the current security futures risk disclosure statement to each customer at or prior to the time such customer’s account is

⁵ See supra note 4.

approved for trading security futures.⁶ Thereafter, the member must distribute each new or revised security futures risk disclosure statement to each customer having an account approved for such trading or, in the alternative, not later than the time a confirmation of a transaction is delivered to each customer that enters into a security futures transaction. The Rule requires FINRA to advise members when a new or revised security futures risk disclosure statement is available.

The Statement is a uniform statement that was jointly developed by several self-regulatory organizations (“SROs”), including FINRA and the NFA, and approved by the SEC in 2002.⁷ Since then, specified sections of the Statement have undergone updates,⁸ the most recent of which occurred in 2018, which incorporated all cumulative updates

⁶ In general, the Security Futures Risk Disclosure Statement provides customers with disclosures regarding the characteristics and potential risks of investing in standardized security futures contracts traded on regulated U.S. exchanges.

⁷ See Securities Exchange Act Release No. 46862 (November 20, 2002), 67 FR 70993 (November 27, 2002) (Order Approving File No. SR-NASD-2002-129); see also Securities Exchange Act Release No. 46613 (October 7, 2002), 67 FR 64176 (October 17, 2002) (Notice of Filing and Effectiveness of File No. SR-NFA-2002-05).

⁸ See Securities Exchange Act Release No. 62787 (August 27, 2010), 75 FR 53998 (September 2, 2010) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2010-045) (revising Section 8.1 of the Statement to indicate that price adjustments for ordinary dividends may be made for a specified class of security future contracts based on the rules of the exchange and the clearing organization); see also Securities Exchange Act Release No. 71981 (April 21, 2014), 79 FR 23034 (April 25, 2014) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2014-019) (revising Section 5.2 of the Statement to list a product with a physical delivery settlement cycle shorter than three business day, and to indicate the then normal clearance and settlement cycle for securities transactions).

made since 2002.⁹ The 2018 Statement is currently posted on FINRA.org.¹⁰

Proposed Updates to the Statement

A. Section 8.2 (Position Limits and Large Trader Reporting)

In general, security futures contracts that trade on U.S.-regulated exchanges are subject to position limits or position accountability rules, and reporting requirements for large open positions. Section 8.2 of the Statement describes, in general terms, these requirements by specifying the position limit thresholds, and reporting requirements for large open positions,¹¹ which accord with CFTC Regulation 41.25 (Additional conditions

⁹ See Securities Exchange Act Release No. 83407 (June 11, 2018), 83 FR 28045 (June 15, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2018-024) (updating Sections 5.2 and 6.1 of the Statement, respectively, to reflect that the normal clearance and settlement cycle for securities transactions is now two business days, and update the address for the Securities Investor Protection Corporation (“SIPC”)); see also Securities Exchange Act Release No. 83825 (August 10, 2018), 83 FR 40819 (August 16, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2018-028) (updating Section 6.1 of the Statement to change the reference to SIPC’s cash limit protection from \$100,000 to \$250,000).

¹⁰ See FINRA’s Security Futures Topic Page, <https://www.finra.org/rules-guidance/key-topics/security-futures>.

¹¹ Section 8.2 provides in part: “Position limits are required for security futures contracts that overlie a security that has an average daily trading volume of 20 million shares or fewer. In the case of a security futures contract overlying a security index, position limits are required if any one of the securities in the index has an average daily trading volume of 20 million shares or fewer. Position limits also apply only to an expiring security futures contract during its last five trading days. A regulated exchange must establish position limits on security futures that are no greater than 13,500 (100 share) contracts, unless the underlying security meets certain volume and shares outstanding thresholds, in which case the limit may be increased to 22,500 (100 share) contracts. For security futures contracts overlying a security or securities with an average trading volume of more than 20 million shares, regulated exchanges may adopt position accountability rules. Under position accountability rules, a trader holding a position in a security futures contract that exceeds 22,500 contracts (or such lower limit established by an exchange) must agree to provide information regarding the position and consent to halt increasing that position if requested by the exchange.” With

for trading for security futures products.), governing position limits and position accountability for security futures products, and Rule 17.02 (Form, manner and time of filing reports.), pertaining to CFTC Form 102 (Identification of “Special Accounts”).¹² The CFTC has amended these requirements and for that reason, FINRA is proposing to update Section 8.2 to reflect the current terms of CFTC Regulation 41.25 and Rule 17.02(b)(2) that increase the default position limits, modify the criteria for setting a higher position limit and position accountability level, and adjust the time during which position limits must be in effect and the time by which firms must submit Form 102 to the CFTC and the exchange on which the reportable position exists.¹³

FINRA is proposing to update the second, third, and fourth paragraphs under Section 8.2 of the Statement to read as follows (proposed updates are marked):

Position limits are required for security futures contracts ~~that overlie~~ on a security ~~that has an average daily trading volume of 20 million shares or fewer.~~ ~~In the case of a security futures contract overlying a security index,~~ position limits are required if any one of the securities in ~~the index has an average daily trading volume of 20 million~~

respect to reporting large open positions, Section 8.2 also indicates that “brokerage firms must submit identifying information on the account holding the reportable position on a form referred to as either an “Identification of Special Accounts Form” or a “Form 102”) to the CFTC and to the exchange on which the reportable position exists within three business days of which a reportable position is first established.”

¹² 17 CFR 17.02(b)(2).

¹³ See supra note 2.

~~shares or fewer.~~ Position limits also apply only to an expiring security futures contract during its last ~~five~~ three trading days. A regulated exchange must establish a default position limits on a security futures contract that ~~are~~ is no greater than ~~13,000~~ 25,000 (100-share) contracts (or the equivalent if the contract size is different than 100 shares), either net or on the same side of the market, unless the underlying security ~~meets certain volume and shares-outstanding thresholds~~ exceeds 20 million shares of estimated deliverable supply, in which case the limit may be ~~increased to 22,500 (100-share) contracts~~ set at a level no greater than 12.5 percent of the estimated deliverable supply of the underlying security, either net or on the same side of the market.

For a security futures contracts ~~overlying on~~ a security ~~or securities~~ with an average a six-month total trading volume of more than ~~20 million~~ 2.5 billion shares and there are more than 40 million shares of estimated deliverable supply, a regulated exchanges may adopt a position accountability rules in lieu of a position limit, either net or on the same side of the market. Under position accountability rules, a trader holding a position in a security futures contract that exceeds ~~22,500~~ 25,000 ~~100-~~

share contracts (or such lower limit established by an exchange the equivalent if the contract size is different than 100 shares) or such lower level specified under the rules of the exchange, must agree to provide information regarding the position and consent to halt increasing that position if requested by the exchange.

Brokerage firms must also report large open positions held by one person (or by several persons acting together) to the CFTC as well as to the exchange on which the positions are held. The CFTC's reporting requirements are 1,000 contracts for security futures positions on individual equity securities and 200 contracts for positions on a narrow-based index. However, individual exchanges may require the reporting of large open positions at levels less than the levels required by the CFTC. In addition, brokerage firms must submit identifying information on the account holding the reportable position (on a form referred to as either an "Identification of Special Accounts Form" or a "Form 102") to the CFTC and to the exchange on which the reportable position exists ~~within three business days of~~ no later than the following business day when a reportable position is first established.

B. Section 2.7 (Trading Halts)

Section 2.7 of the Statement addresses the impact of a trading halt on the value of security futures contracts and states that in certain circumstances, exchanges are required by law to halt trading in security futures contracts. Currently, Section 2.7 states, in part, that “regulated exchanges are required to halt trading in all security futures contracts for a specified period of time when the Dow Jones Industrial Average (“DJIA”) experiences one-day declines of 10-, 20- and 30-percent.” The SEC has approved proposals by SROs, including FINRA, to shift the benchmark against which to assess serious market decline from the DJIA to the S&P 500, and reduce the market decline thresholds to seven-, 13- and 20-percent.¹⁴ FINRA is therefore proposing to update Section 2.7 of the Statement to reflect these changes by updating the fifth sentence of the first paragraph under Section 2.7 to read as follows (proposed updates are marked):

In addition, regulated exchanges are required to halt trading
in all security futures contracts for a specified period of
time when the ~~Dow Jones Industrial Average (“DJIA”)~~
S&P 500 Index experiences one-day declines of ~~10~~ seven-,
~~20~~ 13- and ~~30~~ 20-percent.

C. Introductory Section to the Statement

The Statement begins with a brief introductory section (“Introduction”), stating that the Statement discusses the characteristics and risks of standardized security futures contracts traded on regulated U.S. exchanges. The Introduction also describes the types of securities on which security futures can be based, providing, in part, that “[a]t present,

¹⁴ See supra note 3.

regulated exchanges are authorized to list futures contracts on individual equity securities registered under the Securities Exchange Act of 1934 (including common stock and certain exchange-traded funds and American Depositary Receipts), as well as narrow-based security indices. Futures on other types of securities and options on security futures contracts may be authorized in the future.” The SEC and CFTC adopted SEC Rule 6h-2¹⁵ and an amendment to CFTC Regulation 41.21,¹⁶ respectively, to permit security futures to be based on individual debt securities or narrow-based indexes composed of such securities.¹⁷ In recognition of this change, FINRA is proposing to update the second sentence of the first paragraph of the Introduction to include a reference to debt instruments so that it reads (proposed updates are marked):

At present, regulated exchanges are authorized to list futures contracts on individual equity securities registered under the Securities Exchange Act of 1934 (including common stock and certain exchange-traded funds and American Depositary Receipts), futures on certain debt instruments as well as narrow-based security indices.

¹⁵ 17 CFR 240.6h-2.

¹⁶ 17 CFR 41.21.

¹⁷ See Securities Exchange Act Release No. 54106 (July 6, 2006), 71 FR 39534 (July 13, 2006).

D. Availability of Updated Statement on FINRA.org

Currently, the 2018 Statement and its corresponding 2018 Supplement are posted on FINRA's website.¹⁸ The preceding updates to the Statement made in 2010 and 2014 are also posted on the website.¹⁹ In accordance with existing guidance, a member could satisfy Rule 2370(b)(11)(A) by redistributing the entire Statement to its security futures customers or separately distributing each new supplement to those customers who have already received the Statement.²⁰ FINRA reminds members that they may electronically transmit documents that they are required to furnish to customers under FINRA rules, including the 2020 Statement or 2020 Supplement, provided that members adhere to the standards contained in the SEC's May 1996 and October 1995 releases on electronic delivery,²¹ and as discussed in Notice to Members 98-3. Members may also transmit the 2020 Statement or 2020 Supplement, as appropriate, to customers through the use of a hyperlink, provided that customers have consented to electronic delivery.²²

As noted above, the Statement is a uniform statement that was jointly developed by FINRA, the NFA, and several other securities and futures exchanges. FINRA is

¹⁸ See supra note 10.

¹⁹ See supra note 10.

²⁰ See Information Notice, September 7, 2010 (August 2010 Supplement to the Security Futures Risk Disclosure Statement); see also Regulatory Notice 14-24 (May 2014) (stating, a member may separately distribute new supplements to such customers and that a member is not required to redistribute the entire Statement or earlier supplements).

²¹ See Securities Act Release No. 7288 (May 9, 1996), 61 FR 24644 (May 15, 1996) and Securities Act Release No. 7233 (October 6, 1995), 60 FR 53458 (October 13, 1995). See also Securities Act Release No. 7856 (April 28, 2000), 65 FR 25843 (May 4, 2000) (affirming the framework for electronic delivery established in the 1995 and 1996 releases).

proposing to incorporate the updates proposed herein into the main body of the 2020 Statement and to publish it on the FINRA website.

To facilitate a member's compliance with Rule 2370(b)(11)(A) as articulated in guidance, FINRA is also proposing to encapsulate the proposed updates to the Statement into the 2020 Supplement that would show the proposed updates to Sections 8.2 and 2.7, and the Introduction, as described above. The 2020 Supplement would appear on FINRA's website as a separate document to continue to afford members with the flexibility to comply with the requirements of Rule 2370(b)(11)(A) by separately distributing the Supplement to customers who have already received the 2018 Statement.²³

As noted in Item 2 of this filing, FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, so FINRA can implement the proposed rule change in coordination with the parallel changes that the NFA has proposed to the Statement for its members.²⁴ FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published

²² See supra note 21.

²³ FINRA's Security Futures Topic Page includes an "Archive" in which the 2002 Security Futures Risk Disclosure Statement (with the August 2010 and April 2014 supplements appended), and the separate August 2010 Supplement and April 2014 Supplement currently sit. In an effort to streamline this topic page, FINRA is proposing to remove these older materials from the Archive on the basis that those updates are incorporated into the main body of the Statement. In their stead, FINRA is proposing to move the 2018 Statement and the 2018 Supplement to the "Archive" section of the Security Futures Topic Page.

²⁴ See supra note 4.

no later than 30 days following Commission notice of the filing of the proposed rule change for immediate effectiveness.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²⁵ 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. FINRA believes that updating the Statement to incorporate into the main body all updates discussed within the supplement will help to accurately inform customers of the characteristics and risks of security futures. The proposed updated Statement would also reflect the circumstances under which regulated exchanges are required to halt trading in all security futures contracts and set forth the position limit and accountability rules that currently apply to transactions in security futures.

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. While FINRA recognizes that there may be a burden associated with the distribution of the proposed updated Statement or supplement, FINRA believes that any such burden would be outweighed by the benefit to customers of accurately disclosing the characteristics and risks of security futures. FINRA also believes that any burden will be minimal because firms currently have an existing obligation to deliver each new or updated Statement or supplement to customers. Firms may electronically transmit

²⁵ 15 U.S.C. 78o-3(b)(6).

documents that they are required to furnish to customers under FINRA rules, including the proposed updated Statement or supplement, provided firms adhere to the standards described above. Firms also may transmit the proposed updated Statement or supplement to customers through the use of a hyperlink, provided that customers have consented to electronic delivery.²⁶ Moreover, Rule 2370(b)(11) provides flexibility on when each updated Statement or supplement must be delivered after a customer's account is approved for trading security futures. Instead of having to automatically and immediately distribute an updated Statement or supplement to every customer having an account approved for trading security futures, a firm may distribute an updated Statement or supplement no later than the time a confirmation of a transaction is delivered to each customer who enters into a security futures transaction. Accordingly, firms would not be required to distribute the proposed updated Statement or supplement to customers who have accounts approved for trading security futures but do not engage in any new security futures transactions.

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

Not applicable.

²⁶ See Information Notice, September 7, 2010 (August 2010 Supplement to the Security Futures Risk Disclosure Statement).

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

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act²⁷ and paragraph (f)(6) of Rule 19b-4 thereunder,²⁸ in that the proposed rule change does not significantly affect the protection of investors or the public interest; does not impose any significant burden on competition; and does not become operative for 30 days after filing or such shorter time as the Commission may designate.

The proposed rule change would not significantly affect the protection of investors or the public interest because it seeks to amend the 2018 Statement to be consistent with changes and standards previously approved by the CFTC and SEC. Specifically, as discussed above, FINRA is proposing to update the Statement that was jointly developed by several SROs to conform to the following previously approved changes: (1) the CFTC's standards governing position limits and changes to the large trader reporting timeframe; (2) the shifts to the benchmark and thresholds to assess serious market declines that pertain to trading halts on public exchanges; and (3) the changes to the SEC and CFTC rules permitting security futures to be based on individual debt securities or narrow-based indexes composed of such securities. The NFA has proposed parallel changes to the Statement for its members.²⁹ Accordingly, FINRA has

²⁷ 15 U.S.C. 78s(b)(3)(A).

²⁸ 17 CFR 240.19b-4(f)(6).

²⁹ See supra note 4.

designated the proposed rule change as non-controversial under Section 19(b)(3)(A) of the Act³⁰ and paragraph (f)(6) of Rule 19b-4 thereunder.³¹

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of the filing. However, FINRA requests that the Commission waive the requirement that the rule change, by its terms, not become operative for 30 days after the date of the filing as set forth in Rule 19b-4(f)(6)(iii),³² so that FINRA can implement the proposed rule change in coordination with the parallel changes that the NFA has proposed to the Statement for its members.³³ In accordance with Rule 19b-4(f)(6),³⁴ FINRA submitted written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing, or such shorter time as the Commission may designate, as specified in Rule 19b-4(f)(6)(iii) under the Act.³⁵

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

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

³⁰ 15 U.S.C. 78s(b)(3)(A).

³¹ 17 CFR 240.19b-4(f)(6).

³² 17 CFR 19b-4(f)(6)(iii).

³³ See supra note 4.

³⁴ 17 CFR 240.19b-4(f)(6).

³⁵ 17 CFR 240.19b-4(f)(6)(iii).

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

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

Exhibit 3a. 2020 Security Futures Risk Disclosure Statement.

Exhibit 3b. 2020 Supplement to the Security Futures Risk Disclosure Statement.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2020-025)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend Security Futures Risk Disclosure Statement

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , Financial Industry Regulatory Authority, Inc. (“FINRA”) 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. FINRA has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,³ which renders the proposal effective upon receipt of this filing by the Commission. 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 amend: (1) Section 8.2 (Position Limits and Large Trader Reporting) of the Security Futures Risk Disclosure Statement (“2018 Statement” or “Statement”) to reflect the higher position limits for security futures contracts and changes to the large trader reporting timeframe adopted by the Commodity Futures

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

Trading Commission (“CFTC”);⁴ (2) Section 2.7 (Trading Halts) of the 2018 Statement to reflect the updated market-wide circuit breaker benchmark and thresholds approved by the SEC;⁵ and (3) the introductory section of the 2018 Statement to reflect that exchanges may now list security futures on certain debt instruments. FINRA is not proposing any textual changes to FINRA rules. The National Futures Association (“NFA”) has proposed parallel amendments to the Statement for its members.⁶

The proposed updated Statement (the “2020 Statement”), reflecting all cumulative updates, is attached as Exhibit 3a. The proposed supplement pertaining to changes to the specified paragraphs under Sections 8.2 and 2.7, and the Introduction, as described herein (the “2020 Supplement”) is attached as Exhibit 3b.

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

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

⁴ See Position Limits and Position Accountability for Security Futures Products, 84 FR 51005 (September 27, 2019) (amending CFTC Regulation 41.25); see also Ownership and Control Reports, Forms 102/102S, 40/40S, and 71, 78 FR 69178 (November 18, 2013) (amending CFTC Rule 17.02, among others).

⁵ See Securities Exchange Act Release No. 67090 (May 31, 2012), 77 FR 33531 (June 6, 2012) (Order Approving File No. SR-FINRA-2011-054).

⁶ See Letter from Carol A. Wooding, NFA’s Senior Vice President and General Counsel, to Christopher J. Kirkpatrick, Office of the Secretariat, CFTC, dated May 29, 2020.

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

Background

Subparagraph (A) under Rule 2370(b)(11) (Delivery of Security Futures Risk Disclosure Statement) requires a member to 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.⁷ Thereafter, the member must distribute each new or revised security futures risk disclosure statement to each customer having an account approved for such trading or, in the alternative, not later than the time a confirmation of a transaction is delivered to each customer that enters into a security futures transaction. The Rule requires FINRA to advise members when a new or revised security futures risk disclosure statement is available.

The Statement is a uniform statement that was jointly developed by several self-regulatory organizations ("SROs"), including FINRA and the NFA, and approved by the

⁷ In general, the Security Futures Risk Disclosure Statement provides customers with disclosures regarding the characteristics and potential risks of investing in standardized security futures contracts traded on regulated U.S. exchanges.

SEC in 2002.⁸ Since then, specified sections of the Statement have undergone updates,⁹ the most recent of which occurred in 2018, which incorporated all cumulative updates made since 2002.¹⁰ The 2018 Statement is currently posted on FINRA.org.¹¹

Proposed Updates to the Statement

A. Section 8.2 (Position Limits and Large Trader Reporting)

In general, security futures contracts that trade on U.S.-regulated exchanges are subject to position limits or position accountability rules, and reporting requirements for

⁸ See Securities Exchange Act Release No. 46862 (November 20, 2002), 67 FR 70993 (November 27, 2002) (Order Approving File No. SR-NASD-2002-129); see also Securities Exchange Act Release No. 46613 (October 7, 2002), 67 FR 64176 (October 17, 2002) (Notice of Filing and Effectiveness of File No. SR-NFA-2002-05).

⁹ See Securities Exchange Act Release No. 62787 (August 27, 2010), 75 FR 53998 (September 2, 2010) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2010-045) (revising Section 8.1 of the Statement to indicate that price adjustments for ordinary dividends may be made for a specified class of security future contracts based on the rules of the exchange and the clearing organization); see also Securities Exchange Act Release No. 71981 (April 21, 2014), 79 FR 23034 (April 25, 2014) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2014-019) (revising Section 5.2 of the Statement to list a product with a physical delivery settlement cycle shorter than three business day, and to indicate the then normal clearance and settlement cycle for securities transactions).

¹⁰ See Securities Exchange Act Release No. 83407 (June 11, 2018), 83 FR 28045 (June 15, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2018-024) (updating Sections 5.2 and 6.1 of the Statement, respectively, to reflect that the normal clearance and settlement cycle for securities transactions is now two business days, and update the address for the Securities Investor Protection Corporation (“SIPC”)); see also Securities Exchange Act Release No. 83825 (August 10, 2018), 83 FR 40819 (August 16, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2018-028) (updating Section 6.1 of the Statement to change the reference to SIPC’s cash limit protection from \$100,000 to \$250,000).

¹¹ See FINRA’s Security Futures Topic Page, <https://www.finra.org/rules-guidance/key-topics/security-futures>.

large open positions. Section 8.2 of the Statement describes, in general terms, these requirements by specifying the position limit thresholds, and reporting requirements for large open positions,¹² which accord with CFTC Regulation 41.25 (Additional conditions for trading for security futures products.), governing position limits and position accountability for security futures products, and Rule 17.02 (Form, manner and time of filing reports.), pertaining to CFTC Form 102 (Identification of “Special Accounts”).¹³ The CFTC has amended these requirements and for that reason, FINRA is proposing to update Section 8.2 to reflect the current terms of CFTC Regulation 41.25 and Rule 17.02(b)(2) that increase the default position limits, modify the criteria for setting a higher position limit and position accountability level, and adjust the time during which

¹² Section 8.2 provides in part: “Position limits are required for security futures contracts that overlie a security that has an average daily trading volume of 20 million shares or fewer. In the case of a security futures contract overlying a security index, position limits are required if any one of the securities in the index has an average daily trading volume of 20 million shares or fewer. Position limits also apply only to an expiring security futures contract during its last five trading days. A regulated exchange must establish position limits on security futures that are no greater than 13,500 (100 share) contracts, unless the underlying security meets certain volume and shares outstanding thresholds, in which case the limit may be increased to 22,500 (100 share) contracts. For security futures contracts overlying a security or securities with an average trading volume of more than 20 million shares, regulated exchanges may adopt position accountability rules. Under position accountability rules, a trader holding a position in a security futures contract that exceeds 22,500 contracts (or such lower limit established by an exchange) must agree to provide information regarding the position and consent to halt increasing that position if requested by the exchange.” With respect to reporting large open positions, Section 8.2 also indicates that “brokerage firms must submit identifying information on the account holding the reportable position on a form referred to as either an “Identification of Special Accounts Form” or a “Form 102”) to the CFTC and to the exchange on which the reportable position exists within three business days of which a reportable position is first established.”

¹³ 17 CFR 17.02(b)(2).

position limits must be in effect and the time by which firms must submit Form 102 to the CFTC and the exchange on which the reportable position exists.¹⁴

FINRA is proposing to update the second, third, and fourth paragraphs under Section 8.2 of the Statement to read as follows (proposed updates are marked):

Position limits are required for security futures contracts ~~that overlie~~ on a security ~~that has an average daily trading volume of 20 million shares or fewer. In the case of a security futures contract overlying a security index, position limits are required if any one of the securities in the index has an average daily trading volume of 20 million shares or fewer.~~ Position limits also apply only to an expiring security futures contract during its last ~~five~~ three trading days. A regulated exchange must establish a default position limits on a security futures contract that ~~are~~ is no greater than ~~13,000~~ 25,000 (100-share) contracts (or the equivalent if the contract size is different than 100 shares), either net or on the same side of the market, unless the underlying security meets certain volume and shares outstanding thresholds exceeds 20 million shares of estimated deliverable supply, in which case the limit may be increased to 22,500 (100-share) contracts set at a level no greater than 12.5 percent of the estimated deliverable

¹⁴ See supra note 4.

supply of the underlying security, either net or on the same side of the market.

For a security futures contracts ~~overlying~~ on a security or securities with an average a six-month total trading volume of more than ~~20 million~~ 2.5 billion shares and there are more than 40 million shares of estimated deliverable supply, a regulated exchanges may adopt a position accountability rules in lieu of a position limit, either net or on the same side of the market. Under position accountability rules, a trader holding a position in a security futures contract that exceeds ~~22,500~~ 25,000 100-share contracts (or ~~such lower limit established by an exchange~~ the equivalent if the contract size is different than 100 shares) or such lower level specified under the rules of the exchange, must agree to provide information regarding the position and consent to halt increasing that position if requested by the exchange.

Brokerage firms must also report large open positions held by one person (or by several persons acting together) to the CFTC as well as to the exchange on which the positions are held. The CFTC's reporting requirements are 1,000 contracts for security futures positions on individual equity securities and 200 contracts for positions

on a narrow-based index. However, individual exchanges may require the reporting of large open positions at levels less than the levels required by the CFTC. In addition, brokerage firms must submit identifying information on the account holding the reportable position (on a form referred to as either an “Identification of Special Accounts Form” or a “Form 102”) to the CFTC and to the exchange on which the reportable position exists ~~within three business days of~~ no later than the following business day when a reportable position is first established.

B. Section 2.7 (Trading Halts)

Section 2.7 of the Statement addresses the impact of a trading halt on the value of security futures contracts and states that in certain circumstances, exchanges are required by law to halt trading in security futures contracts. Currently, Section 2.7 states, in part, that “regulated exchanges are required to halt trading in all security futures contracts for a specified period of time when the Dow Jones Industrial Average (“DJIA”) experiences one-day declines of 10-, 20- and 30-percent.” The SEC has approved proposals by SROs, including FINRA, to shift the benchmark against which to assess serious market decline from the DJIA to the S&P 500, and reduce the market decline thresholds to seven-, 13- and 20-percent.¹⁵ FINRA is therefore proposing to update Section 2.7 of the Statement to reflect these changes by updating the fifth sentence of the first paragraph under Section 2.7 to read as follows (proposed updates are marked):

¹⁵ See supra note 5.

In addition, regulated exchanges are required to halt trading in all security futures contracts for a specified period of time when the ~~Dow Jones Industrial Average (“DJIA”)~~ S&P 500 Index experiences one-day declines of ~~40~~ seven-, ~~20~~ 13- and ~~30~~ 20-percent.

C. Introductory Section to the Statement

The Statement begins with a brief introductory section (“Introduction”), stating that the Statement discusses the characteristics and risks of standardized security futures contracts traded on regulated U.S. exchanges. The Introduction also describes the types of securities on which security futures can be based, providing, in part, that “[a]t present, regulated exchanges are authorized to list futures contracts on individual equity securities registered under the Securities Exchange Act of 1934 (including common stock and certain exchange-traded funds and American Depositary Receipts), as well as narrow-based security indices. Futures on other types of securities and options on security futures contracts may be authorized in the future.” The SEC and CFTC adopted SEC Rule 6h-2¹⁶ and an amendment to CFTC Regulation 41.21,¹⁷ respectively, to permit security futures to be based on individual debt securities or narrow-based indexes composed of such securities.¹⁸ In recognition of this change, FINRA is proposing to

¹⁶ 17 CFR 240.6h-2.

¹⁷ 17 CFR 41.21.

¹⁸ See Securities Exchange Act Release No. 54106 (July 6, 2006), 71 FR 39534 (July 13, 2006).

update the second sentence of the first paragraph of the Introduction to include a reference to debt instruments so that it reads (proposed updates are marked):

At present, regulated exchanges are authorized to list futures contracts on individual equity securities registered under the Securities Exchange Act of 1934 (including common stock and certain exchange-traded funds and American Depositary Receipts), futures on certain debt instruments as well as narrow-based security indices.

D. Availability of Updated Statement on FINRA.org

Currently, the 2018 Statement and its corresponding 2018 Supplement are posted on FINRA's website.¹⁹ The preceding updates to the Statement made in 2010 and 2014 are also posted on the website.²⁰ In accordance with existing guidance, a member could satisfy Rule 2370(b)(11)(A) by redistributing the entire Statement to its security futures customers or separately distributing each new supplement to those customers who have already received the Statement.²¹ FINRA reminds members that they may electronically transmit documents that they are required to furnish to customers under FINRA rules, including the 2020 Statement or 2020 Supplement, provided that members adhere to the standards contained in the SEC's May 1996 and October 1995 released on electronic

¹⁹ See supra note 11.

²⁰ See supra note 11.

²¹ See Information Notice, September 7, 2010 (August 2010 Supplement to the Security Futures Risk Disclosure Statement); see also Regulatory Notice 14-24 (May 2014) (stating, a member may separately distribute new supplements to such customers and that a member is not required to redistribute the entire Statement or earlier supplements).

delivery,²² and as discussed in Notice to Members 98-3. Members may also transmit the 2020 Statement or 2020 Supplement, as appropriate, to customers through the use of a hyperlink, provided that customers have consented to electronic delivery.²³

As noted above, the Statement is a uniform statement that was jointly developed by FINRA, the NFA, and several other securities and futures exchanges. FINRA is proposing to incorporate the updates proposed herein into the main body of the 2020 Statement and to publish it on the FINRA website.

To facilitate a member's compliance with Rule 2370(b)(11)(A) as articulated in guidance, FINRA is also proposing to encapsulate the proposed updates to the Statement into the 2020 Supplement that would show the proposed updates to Sections 8.2 and 2.7, and the Introduction, as described above. The 2020 Supplement would appear on FINRA's website as a separate document to continue to afford members with the flexibility to comply with the requirements of Rule 2370(b)(11)(A) by separately distributing the Supplement to customers who have already received the 2018 Statement.²⁴

²² See Securities Act Release No. 7288 (May 9, 1996), 61 FR 24644 (May 15, 1996) and Securities Act Release No. 7233 (October 6, 1995), 60 FR 53458 (October 13, 1995). See also Securities Act Release No. 7856 (April 28, 2000), 65 FR 25843 (May 4, 2000) (affirming the framework for electronic delivery established in the 1995 and 1996 releases).

²³ See supra note 22.

²⁴ FINRA's Security Futures Topic Page includes an "Archive" in which the 2002 Security Futures Risk Disclosure Statement (with the August 2010 and April 2014 supplements appended), and the separate August 2010 Supplement and April 2014 Supplement currently sit. In an effort to streamline this topic page, FINRA is proposing to remove these older materials from the Archive on the basis that those updates are incorporated into the main body of the Statement. In their stead,

FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, so FINRA can implement the proposed rule change in coordination with the parallel changes that the NFA has proposed to the Statement for its members.²⁵ FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 30 days following Commission notice of the filing of the proposed rule change for immediate effectiveness.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²⁶ 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. FINRA believes that updating the Statement to incorporate into the main body all updates discussed within the supplement will help to accurately inform customers of the characteristics and risks of security futures. The proposed updated Statement would also reflect the circumstances under which regulated exchanges are required to halt trading in all security futures contracts and set forth the position limit and accountability rules that currently apply to transactions in security futures.

FINRA is proposing to move the 2018 Statement and the 2018 Supplement to the “Archive” section of the Security Futures Topic Page.

²⁵ See supra note 6.

²⁶ 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. While FINRA recognizes that there may be a burden associated with the distribution of the proposed updated Statement or supplement, FINRA believes that any such burden would be outweighed by the benefit to customers of accurately disclosing the characteristics and risks of security futures. FINRA also believes that any burden will be minimal because firms currently have an existing obligation to deliver each new or updated Statement or supplement to customers. Firms may electronically transmit documents that they are required to furnish to customers under FINRA rules, including the proposed updated Statement or supplement, provided firms adhere to the standards described above. Firms also may transmit the proposed updated Statement or supplement to customers through the use of a hyperlink, provided that customers have consented to electronic delivery.²⁷ Moreover, Rule 2370(b)(11) provides flexibility on when each updated Statement or supplement must be delivered after a customer's account is approved for trading security futures. Instead of having to automatically and immediately distribute an updated Statement or supplement to every customer having an account approved for trading security futures, a firm may distribute an updated Statement or supplement no later than the time a confirmation of a transaction is delivered to each customer who enters into a security futures transaction. Accordingly, firms would not be required to distribute the proposed updated Statement or supplement to customers who

²⁷ See Information Notice, September 7, 2010 (August 2010 Supplement to the Security Futures Risk Disclosure Statement).

have accounts approved for trading security futures but do not engage in any new security futures transactions.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act²⁸ and Rule 19b-4(f)(6) thereunder.²⁹

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or 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:

²⁸ 15 U.S.C. 78s(b)(3)(A).

²⁹ 17 CFR 240.19b-4(f)(6).

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. Please include File Number SR-FINRA-2020-025 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2020-025. 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 website (<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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. 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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only

information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2020-025 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.³⁰

Jill M. Peterson
Assistant Secretary

³⁰ 17 CFR 200.30-3(a)(12).

Exhibit 3a shows the text of the Risk Disclosure Statement for Security Futures Contracts. The text of the proposed new language is underlined and deletions are in brackets.

* * * * *

RISK DISCLOSURE STATEMENT FOR SECURITY FUTURES CONTRACTS

This disclosure statement discusses the characteristics and risks of standardized security futures contracts traded on regulated U.S. exchanges. At present, regulated exchanges are authorized to list futures contracts on individual equity securities registered under the Securities Exchange Act of 1934 (including common stock and certain exchange-traded funds and American Depositary Receipts), futures on certain debt instruments as well as narrow-based security indices. Futures on other types of securities and options on security futures contracts may be authorized in the future. The glossary of terms appears at the end of the document.

Customers should be aware that the examples in this document are exclusive of fees and commissions that may decrease their net gains or increase their net losses. The examples also do not include tax consequences, which may differ for each customer.

Section 1 – Risks of Security Futures

1.1. Risks of Security Futures Transactions

Trading security futures contracts may not be suitable for all investors. You may lose a substantial amount of money in a very short period of time. The amount you may lose is potentially unlimited and can exceed the amount you originally deposit with your broker. This is because futures trading is highly leveraged, with a relatively small amount of money used to establish a position in assets having a much greater value. If

you are uncomfortable with this level of risk, you should not trade security futures contracts.

1.2. General Risks

- ***Trading security futures contracts involves risk and may result in potentially unlimited losses that are greater than the amount you deposited with your broker.***

As with any high risk financial product, you should not risk any funds that you cannot afford to lose, such as your retirement savings, medical and other emergency funds, funds set aside for purposes such as education or home ownership, proceeds from student loans or mortgages, or funds required to meet your living expenses.

- ***Be cautious of claims that you can make large profits from trading security futures contracts.*** Although the high degree of leverage in security futures contracts can result in large and immediate gains, it can also result in large and immediate losses.

As with any financial product, there is no such thing as a “sure winner.”

- ***Because of the leverage involved and the nature of security futures contract transactions, you may feel the effects of your losses immediately.*** Gains and losses in security futures contracts are credited or debited to your account, at a minimum, on a daily basis. If movements in the markets for security futures contracts or the underlying security decrease the value of your positions in security futures contracts, you may be required to have or make additional funds available to your carrying firm as margin. If your account is under the minimum margin requirements set by the exchange or the brokerage firm, your position may be liquidated at a loss, and you will be liable for the deficit, if any, in your account. Margin requirements are addressed in Section 4.

- ***Under certain market conditions, it may be difficult or impossible to liquidate a position.*** Generally, you must enter into an offsetting transaction in order to liquidate a position in a security futures contract. If you cannot liquidate your position in security futures contracts, you may not be able to realize a gain in the value of your position or prevent losses from mounting. This inability to liquidate could occur, for example, if trading is halted due to unusual trading activity in either the security futures contract or the underlying security; if trading is halted due to recent news events involving the issuer of the underlying security; if systems failures occur on an exchange or at the firm carrying your position; or if the position is on an illiquid market. Even if you can liquidate your position, you may be forced to do so at a price that involves a large loss.
- ***Under certain market conditions, it may also be difficult or impossible to manage your risk from open security futures positions by entering into an equivalent but opposite position in another contract month, on another market, or in the underlying security.*** This inability to take positions to limit your risk could occur, for example, if trading is halted across markets due to unusual trading activity in the security futures contract or the underlying security or due to recent news events involving the issuer of the underlying security.
- ***Under certain market conditions, the prices of security futures contracts may not maintain their customary or anticipated relationships to the prices of the underlying security or index.*** These pricing disparities could occur, for example, when the market for the security futures contract is illiquid, when the primary market for the underlying security is closed, or when the reporting of transactions in the

- underlying security has been delayed. For index products, it could also occur when trading is delayed or halted in some or all of the securities that make up the index.
- ***You may be required to settle certain security futures contracts with physical delivery of the underlying security.*** If you hold your position in a physically settled security futures contract until the end of the last trading day prior to expiration, you will be obligated to make or take delivery of the underlying securities, which could involve additional costs. The actual settlement terms may vary from contract to contract and exchange to exchange. You should carefully review the settlement and delivery conditions before entering into a security futures contract. Settlement and delivery are discussed in Section 5.
 - ***You may experience losses due to systems failures.*** As with any financial transaction, you may experience losses if your orders for security futures contracts cannot be executed normally due to systems failures on a regulated exchange or at the brokerage firm carrying your position. Your losses may be greater if the brokerage firm carrying your position does not have adequate back-up systems or procedures.
 - ***All security futures contracts involve risk, and there is no trading strategy that can eliminate it.*** Strategies using combinations of positions, such as spreads, may be as risky as outright long or short positions. Trading in security futures contracts requires knowledge of both the securities and the futures markets.
 - ***Day trading strategies involving security futures contracts and other products pose special risks.*** As with any financial product, persons who seek to purchase and sell the same security future in the course of a day to profit from intra-day price movements (“day traders”) face a number of special risks, including substantial

commissions, exposure to leverage, and competition with professional traders. You should thoroughly understand these risks and have appropriate experience before engaging in day trading. The special risks for day traders are discussed more fully in Section 7.

- ***Placing contingent orders, if permitted, such as “stop-loss” or “stop-limit” orders, will not necessarily limit your losses to the intended amount.*** Some regulated exchanges may permit you to enter into stop-loss or stop-limit orders for security futures contracts, which are intended to limit your exposure to losses due to market fluctuations. However, market conditions may make it impossible to execute the order or to get the stop price.
- ***You should thoroughly read and understand the customer account agreement with your brokerage firm before entering into any transactions in security futures contracts.***
- ***You should thoroughly understand the regulatory protections available to your funds and positions in the event of the failure of your brokerage firm.*** The regulatory protections available to your funds and positions in the event of the failure of your brokerage firm may vary depending on, among other factors, the contract you are trading and whether you are trading through a securities account or a futures account. Firms that allow customers to trade security futures in either securities accounts or futures accounts, or both, are required to disclose to customers the differences in regulatory protections between such accounts, and, where appropriate, how customers may elect to trade in either type of account.

Section 2 – Description of a Security Futures Contract

2.1. What is a Security Futures Contract?

A security futures contract is a legally binding agreement between two parties to purchase or sell in the future a specific quantity of shares of a security or of the component securities of a narrow-based security index, at a certain price. A person who buys a security futures contract enters into a contract to purchase an underlying security and is said to be “long” the contract. A person who sells a security futures contract enters into a contract to sell the underlying security and is said to be “short” the contract. The price at which the contract trades (the “contract price”) is determined by relative buying and selling interest on a regulated exchange.

In order to enter into a security futures contract, you must deposit funds with your brokerage firm equal to a specified percentage (usually at least 20 percent) of the current market value of the contract as a performance bond. Moreover, all security futures contracts are marked-to-market at least daily, usually after the close of trading, as described in Section 3 of this document. At that time, the account of each buyer and seller reflects the amount of any gain or loss on the security futures contract based on the contract price established at the end of the day for settlement purposes (the “daily settlement price”).

An open position, either a long or short position, is closed or liquidated by entering into an offsetting transaction (i.e., an equal and opposite transaction to the one that opened the position) prior to the contract expiration. Traditionally, most futures contracts are liquidated prior to expiration through an offsetting transaction and, thus, holders do not incur a settlement obligation.

Examples:

Investor A is long one September XYZ Corp. futures contract. To liquidate the long position in the September XYZ Corp. futures contract, Investor A would sell an identical September XYZ Corp. contract.

Investor B is short one December XYZ Corp. futures contract. To liquidate the short position in the December XYZ Corp. futures contract, Investor B would buy an identical December XYZ Corp. contract.

Security futures contracts that are not liquidated prior to expiration must be settled in accordance with the terms of the contract. Some security futures contracts are settled by physical delivery of the underlying security. At the expiration of a security futures contract that is settled through physical delivery, a person who is long the contract must pay the final settlement price set by the regulated exchange or the clearing organization and take delivery of the underlying shares. Conversely, a person who is short the contract must make delivery of the underlying shares in exchange for the final settlement price.

Other security futures contracts are settled through cash settlement. In this case, the underlying security is not delivered. Instead, any positions in such security futures contracts that are open at the end of the last trading day are settled through a final cash payment based on a final settlement price determined by the exchange or clearing organization. Once this payment is made, neither party has any further obligations on the contract.

Physical delivery and cash settlement are discussed more fully in Section 5.

2.2. Purposes of Security Futures

Security futures contracts can be used for speculation, hedging, and risk management. Security futures contracts do not provide capital growth or income.

Speculation

Speculators are individuals or firms who seek to profit from anticipated increases or decreases in futures prices. A speculator who expects the price of the underlying instrument to increase will buy the security futures contract. A speculator who expects the price of the underlying instrument to decrease will sell the security futures contract. Speculation involves substantial risk and can lead to large losses as well as profits.

The most common trading strategies involving security futures contracts are buying with the hope of profiting from an anticipated price increase and selling with the hope of profiting from an anticipated price decrease. For example, a person who expects the price of XYZ stock to increase by March can buy a March XYZ security futures contract, and a person who expects the price of XYZ stock to decrease by March can sell a March XYZ security futures contract. The following illustrates potential profits and losses if Customer A purchases the security futures contract at \$50 a share and Customer B sells the same contract at \$50 a share (assuming 100 shares per contract).

<u>Price of XYZ at Liquidation</u>	<u>Customer A Profit/Loss</u>	<u>Customer B Profit/Loss</u>
\$55	\$500	- \$500
\$50	\$0	\$0
\$45	- \$500	\$500

Speculators may also enter into spreads with the hope of profiting from an expected change in price relationships. Spreaders may purchase a contract expiring in one contract month and sell another contract on the same underlying security expiring in a different month (e.g., buy June and sell September XYZ single stock futures). This is commonly referred to as a “calendar spread.”

Spreaders may also purchase and sell the same contract month in two different but economically correlated security futures contracts. For example, if ABC and XYZ are both pharmaceutical companies and an individual believes that ABC will have stronger growth than XYZ between now and June, he could buy June ABC futures contracts and sell June XYZ futures contracts. Assuming that each contract is 100 shares, the following illustrates how this works.

<u>Opening Position</u>	<u>Price at Liquidation</u>	<u>Gain or Loss</u>	<u>Price at Liquidation</u>	<u>Gain or Loss</u>
Buy ABC at 50	\$53	\$300	\$53	\$300
Sell XYZ at 45	\$46	-\$100	\$50	-\$500
Net Gain or Loss		\$200		-\$200

Speculators can also engage in arbitrage, which is similar to a spread except that the long and short positions occur on two different markets. An arbitrage position can be established by taking an economically opposite position in a security futures contract on another exchange, in an options contract, or in the underlying security.

Hedging

Generally speaking, hedging involves the purchase or sale of a security future to reduce or offset the risk of a position in the underlying security or group of securities (or a close economic equivalent). A hedger gives up the potential to profit from a favorable

price change in the position being hedged in order to minimize the risk of loss from an adverse price change.

An investor who wants to lock in a price now for an anticipated sale of the underlying security at a later date can do so by hedging with security futures. For example, assume an investor owns 1,000 shares of ABC that have appreciated since he bought them. The investor would like to sell them at the current price of \$50 per share, but there are tax or other reasons for holding them until September. The investor could sell ten 100-share ABC futures contracts and then buy back those contracts in September when he sells the stock. Assuming the stock price and the futures price change by the same amount, the gain or loss in the stock will be offset by the loss or gain in the futures contracts.

<u>Price in September</u>	<u>Value of 1,000 Shares of ABC</u>	<u>Gain or Loss on Futures</u>	<u>Effective Selling Price</u>
\$40	\$40,000	\$10,000	\$50,000
\$50	\$50,000	\$ 0	\$50,000
\$60	\$60,000	-\$10,000	\$50,000

Hedging can also be used to lock in a price now for an anticipated purchase of the stock at a later date. For example, assume that in May a mutual fund expects to buy stocks in a particular industry with the proceeds of bonds that will mature in August. The mutual fund can hedge its risk that the stocks will increase in value between May and August by purchasing security futures contracts on a narrow-based index of stocks from that industry. When the mutual fund buys the stocks in August, it also will liquidate the security futures position in the index. If the relationship between the security futures contract and the stocks in the index is constant, the profit or loss from the futures contract

will offset the price change in the stocks, and the mutual fund will have locked in the price that the stocks were selling at in May.

Although hedging mitigates risk, it does not eliminate all risk. For example, the relationship between the price of the security futures contract and the price of the underlying security traditionally tends to remain constant over time, but it can and does vary somewhat. Furthermore, the expiration or liquidation of the security futures contract may not coincide with the exact time the hedger buys or sells the underlying stock. Therefore, hedging may not be a perfect protection against price risk.

Risk Management

Some institutions also use futures contracts to manage portfolio risks without necessarily intending to change the composition of their portfolio by buying or selling the underlying securities. The institution does so by taking a security futures position that is opposite to some or all of its position in the underlying securities. This strategy involves more risk than a traditional hedge because it is not meant to be a substitute for an anticipated purchase or sale.

2.3. Where Security Futures Trade

By law, security futures contracts must trade on a regulated U.S. exchange. Each regulated U.S. exchange that trades security futures contracts is subject to joint regulation by the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC).

A person holding a position in a security futures contract who seeks to liquidate the position must do so either on the regulated exchange where the original trade took place or on another regulated exchange, if any, where a fungible security futures contract

trades. (A person may also seek to manage the risk in that position by taking an opposite position in a comparable contract traded on another regulated exchange.)

Security futures contracts traded on one regulated exchange might not be fungible with security futures contracts traded on another regulated exchange for a variety of reasons. Security futures traded on different regulated exchanges may be non-fungible because they have different contract terms (e.g., size, settlement method), or because they are cleared through different clearing organizations. Moreover, a regulated exchange might not permit its security futures contracts to be offset or liquidated by an identical contract traded on another regulated exchange, even though they have the same contract terms and are cleared through the same clearing organization. You should consult your broker about the fungibility of the contract you are considering purchasing or selling, including which exchange(s), if any, on which it may be offset.

Regulated exchanges that trade security futures contracts are required by law to establish certain listing standards. Changes in the underlying security of a security futures contract may, in some cases, cause such contract to no longer meet the regulated exchange's listing standards. Each regulated exchange will have rules governing the continued trading of security futures contracts that no longer meet the exchange's listing standards. These rules may, for example, permit only liquidating trades in security futures contracts that no longer satisfy the listing standards.

2.4. How Security Futures Differ from the Underlying Security

Shares of common stock represent a fractional ownership interest in the issuer of that security. Ownership of securities confers various rights that are not present with positions in security futures contracts. For example, persons owning a share of common

stock may be entitled to vote in matters affecting corporate governance. They also may be entitled to receive dividends and corporate disclosure, such as annual and quarterly reports.

The purchaser of a security futures contract, by contrast, has only a contract for future delivery of the underlying security. The purchaser of the security futures contract is not entitled to exercise any voting rights over the underlying security and is not entitled to any dividends that may be paid by the issuer. Moreover, the purchaser of a security futures contract does not receive the corporate disclosures that are received by shareholders of the underlying security, although such corporate disclosures must be made publicly available through the SEC's EDGAR system, which can be accessed at www.sec.gov. You should review such disclosures before entering into a security futures contract. See Section 8.1 for further discussion of the impact of corporate events on a security futures contract.

All security futures contracts are marked-to-market at least daily, usually after the close of trading, as described in Section 3 of this document. At that time, the account of each buyer and seller is credited with the amount of any gain, or debited by the amount of any loss, on the security futures contract, based on the contract price established at the end of the day for settlement purposes (the "daily settlement price"). By contrast, the purchaser or seller of the underlying instrument does not have the profit and loss from his or her investment credited or debited until the position in that instrument is closed out.

Naturally, as with any financial product, the value of the security futures contract and of the underlying security may fluctuate. However, owning the underlying security does not require an investor to settle his or her profits and losses daily. By contrast, as a

result of the mark-to-market requirements discussed above, a person who is long a security futures contract often will be required to deposit additional funds into his or her account as the price of the security futures contract decreases. Similarly, a person who is short a security futures contract often will be required to deposit additional funds into his or her account as the price of the security futures contract increases.

Another significant difference is that security futures contracts expire on a specific date. Unlike an owner of the underlying security, a person cannot hold a long position in a security futures contract for an extended period of time in the hope that the price will go up. If you do not liquidate your security futures contract, you will be required to settle the contract when it expires, either through physical delivery or cash settlement. For cash-settled contracts in particular, upon expiration, an individual will no longer have an economic interest in the securities underlying the security futures contract.

2.5. Comparison to Options

Although security futures contracts share some characteristics with options on securities (options contracts), these products are also different in a number of ways. Below are some of the important distinctions between equity options contracts and security futures contracts.

If you purchase an options contract, you have the right, but not the obligation, to buy or sell a security prior to the expiration date. If you sell an options contract, you have the obligation to buy or sell a security prior to the expiration date. By contrast, if you have a position in a security futures contract (either long or short), you have both the right and the obligation to buy or sell a security at a future date. The only way that you

can avoid the obligation incurred by the security futures contract is to liquidate the position with an offsetting contract.

A person purchasing an options contract runs the risk of losing the purchase price (premium) for the option contract. Because it is a wasting asset, the purchaser of an options contract who neither liquidates the options contract in the secondary market nor exercises it at or prior to expiration will necessarily lose his or her entire investment in the options contract. However, a purchaser of an options contract cannot lose more than the amount of the premium. Conversely, the seller of an options contract receives the premium and assumes the risk that he or she will be required to buy or sell the underlying security on or prior to the expiration date, in which event his or her losses may exceed the amount of the premium received. Although the seller of an options contract is required to deposit margin to reflect the risk of its obligation, he or she may lose many times his or her initial margin deposit.

By contrast, the purchaser and seller of a security futures contract each enter into an agreement to buy or sell a specific quantity of shares in the underlying security. Based upon the movement in prices of the underlying security, a person who holds a position in a security futures contract can gain or lose many times his or her initial margin deposit. In this respect, the benefits of a security futures contract are similar to the benefits of *purchasing* an option, while the risks of entering into a security futures contract are similar to the risks of *selling* an option.

Both the purchaser and the seller of a security futures contract have daily margin obligations. At least once each day, security futures contracts are marked-to-market and the increase or decrease in the value of the contract is credited or debited to the buyer and

the seller. As a result, any person who has an open position in a security futures contract may be called upon to meet additional margin requirements or may receive a credit of available funds. Example:

Assume that Customers A and B each anticipate an increase in the market price of XYZ stock, which is currently \$50 a share. Customer A purchases an XYZ 50 call (covering 100 shares of XYZ at a premium of \$5 per share). The option premium is \$500 (\$5 per share X 100 shares). Customer B purchases an XYZ security futures contract (covering 100 shares of XYZ). The total value of the contract is \$5000 (\$50 share value X 100 shares). The required margin is \$1000 (or 20% of the contract value).

Price of XYZ at <u>Expiration</u>	Customer A <u>Profit/Loss</u>	Customer B <u>Profit/Loss</u>
65	\$1000	\$ 1500
60	\$ 500	\$ 1000
55	\$ 0	\$ 500
50	-\$ 500	\$ 0
45	-\$ 500	-\$ 500
40	-\$ 500	-\$ 1000
35	-\$ 500	-\$ 1500

The most that Customer A can lose is \$500, the option premium. Customer A breaks even at \$55 per share, and makes money at higher prices. Customer B may lose more than his initial margin deposit. Unlike the options premium, the margin on a futures contract is not a cost but

a performance bond. The losses for Customer B are not limited by this performance bond. Rather, the losses or gains are determined by the settlement price of the contract, as provided in the example above. Note that if the price of XYZ falls to \$35 per share, Customer A loses only \$500, whereas Customer B loses \$1500.

2.6. Components of a Security Futures Contract

Each regulated exchange can choose the terms of the security futures contracts it lists, and those terms may differ from exchange to exchange or contract to contract. Some of those contract terms are discussed below. However, you should ask your broker for a copy of the contract specifications before trading a particular contract.

2.6.1. Each security futures contract has a set size. The size of a security futures contract is determined by the regulated exchange on which the contract trades. For example, a security futures contract for a single stock may be based on 100 shares of that stock. If prices are reported per share, the value of the contract would be the price times 100. For narrow-based security indices, the value of the contract is the price of the component securities times the multiplier set by the exchange as part of the contract terms.

2.6.2. Security futures contracts expire at set times determined by the listing exchange. For example, a particular contract may expire on a particular day, e.g., the third Friday of the expiration month. Up until expiration, you may liquidate an open position by offsetting your contract with a fungible opposite contract that expires in the same month.

If you do not liquidate an open position before it expires, you will be required to make or take delivery of the underlying security or to settle the contract in cash after expiration.

2.6.3. Although security futures contracts on a particular security or a narrow-based security index may be listed and traded on more than one regulated exchange, the contract specifications may not be the same. Also, prices for contracts on the same security or index may vary on different regulated exchanges because of different contract specifications.

2.6.4. Prices of security futures contracts are usually quoted the same way prices are quoted in the underlying instrument. For example, a contract for an individual security would be quoted in dollars and cents per share. Contracts for indices would be quoted by an index number, usually stated to two decimal places.

2.6.5. Each security futures contract has a minimum price fluctuation (called a tick), which may differ from product to product or exchange to exchange. For example, if a particular security futures contract has a tick size of 1¢, you can buy the contract at \$23.21 or \$23.22 but not at \$23.215.

2.7. Trading Halts

The value of your positions in security futures contracts could be affected if trading is halted in either the security futures contract or the underlying security. In certain circumstances, regulated exchanges are required by law to halt trading in security futures contracts. For example, trading on a particular security futures contract must be halted if trading is halted on the listed market for the underlying security as a result of pending news, regulatory concerns, or market volatility. Similarly, trading of a security futures contract on a narrow-based security index must be halted under such

circumstances if trading is halted on securities accounting for at least 50 percent of the market capitalization of the index. In addition, regulated exchanges are required to halt trading in all security futures contracts for a specified period of time when the [Dow Jones Industrial Average (“DJIA”)]S&P 500 Index experiences one-day declines of [10]seven-, [20]13- and [30]20-percent. The regulated exchanges may also have discretion under their rules to halt trading in other circumstances – such as when the exchange determines that the halt would be advisable in maintaining a fair and orderly market.

A trading halt, either by a regulated exchange that trades security futures or an exchange trading the underlying security or instrument, could prevent you from liquidating a position in security futures contracts in a timely manner, which could prevent you from liquidating a position in security futures contracts at that time.

2.8. Trading Hours

Each regulated exchange trading a security futures contract may open and close for trading at different times than other regulated exchanges trading security futures contracts or markets trading the underlying security or securities. Trading in security futures contracts prior to the opening or after the close of the primary market for the underlying security may be less liquid than trading during regular market hours.

Section 3 – Clearing Organizations and Mark-to-Market Requirements

Every regulated U.S. exchange that trades security futures contracts is required to have a relationship with a clearing organization that serves as the guarantor of each security futures contract traded on that exchange. A clearing organization performs the

following functions: matching trades; effecting settlement and payments; guaranteeing performance; and facilitating deliveries.

Throughout each trading day, the clearing organization matches trade data submitted by clearing members on behalf of their customers or for the clearing member's proprietary accounts. If an account is with a brokerage firm that is not a member of the clearing organization, then the brokerage firm will carry the security futures position with another brokerage firm that is a member of the clearing organization. Trade records that do not match, either because of a discrepancy in the details or because one side of the transaction is missing, are returned to the submitting clearing members for resolution. The members are required to resolve such "out trades" before or on the open of trading the next morning.

When the required details of a reported transaction have been verified, the clearing organization assumes the legal and financial obligations of the parties to the transaction. One way to think of the role of the clearing organization is that it is the "buyer to every seller and the seller to every buyer." The insertion or substitution of the clearing organization as the counterparty to every transaction enables a customer to liquidate a security futures position without regard to what the other party to the original security futures contract decides to do.

The clearing organization also effects the settlement of gains and losses from security futures contracts between clearing members. At least once each day, clearing member brokerage firms must either pay to, or receive from, the clearing organization the difference between the current price and the trade price earlier in the day, or for a position carried over from the previous day, the difference between the current price and

the previous day's settlement price. Whether a clearing organization effects settlement of gains and losses on a daily basis or more frequently will depend on the conventions of the clearing organization and market conditions. Because the clearing organization assumes the legal and financial obligations for each security futures contract, you should expect it to ensure that payments are made promptly to protect its obligations.

Gains and losses in security futures contracts are also reflected in each customer's account on at least a daily basis. Each day's gains and losses are determined based on a daily settlement price disseminated by the regulated exchange trading the security futures contract or its clearing organization. If the daily settlement price of a particular security futures contract rises, the buyer has a gain and the seller a loss. If the daily settlement price declines, the buyer has a loss and the seller a gain. This process is known as "marking-to-market" or daily settlement. As a result, individual customers normally will be called on to settle daily.

The one-day gain or loss on a security futures contract is determined by calculating the difference between the current day's settlement price and the previous day's settlement price.

For example, assume a security futures contract is purchased at a price of \$120. If the daily settlement price is either \$125 (higher) or \$117 (lower), the effects would be as follows:

(1 contract representing 100 shares)

Daily Settlement <u>Value</u>	Buyer's <u>Account</u>	Seller's <u>Account</u>
\$125	\$500 gain (credit)	\$500 loss (debit)
\$117	\$300 loss (debit)	\$300 gain (credit)

The cumulative gain or loss on a customer's open security futures positions is generally referred to as "open trade equity" and is listed as a separate component of account equity on your customer account statement.

A discussion of the role of the clearing organization in effecting delivery is discussed in Section 5.

Section 4 – Margin and Leverage

When a broker-dealer lends a customer part of the funds needed to purchase a security such as common stock, the term "margin" refers to the amount of cash, or down payment, the customer is required to deposit. By contrast, a security futures contract is an obligation and not an asset. A security futures contract has no value as collateral for a loan. Because of the potential for a loss as a result of the daily marked-to-market process, however, a margin deposit is required of each party to a security futures contract. This required margin deposit also is referred to as a "performance bond."

In the first instance, margin requirements for security futures contracts are set by the exchange on which the contract is traded, subject to certain minimums set by law. The basic margin requirement is 20% of the current value of the security futures contract, although some strategies may have lower margin requirements. Requests for additional

margin are known as “margin calls.” Both buyer and seller must individually deposit the required margin to their respective accounts.

It is important to understand that individual brokerage firms can, and in many cases do, require margin that is higher than the exchange requirements. Additionally, margin requirements may vary from brokerage firm to brokerage firm. Furthermore, a brokerage firm can increase its “house” margin requirements at any time without providing advance notice, and such increases could result in a margin call.

For example, some firms may require margin to be deposited the business day following the day of a deficiency, or some firms may even require deposit on the same day. Some firms may require margin to be on deposit in the account before they will accept an order for a security futures contract. Additionally, brokerage firms may have special requirements as to how margin calls are to be met, such as requiring a wire transfer from a bank, or deposit of a certified or cashier’s check. You should thoroughly read and understand the customer agreement with your brokerage firm before entering into any transactions in security futures contracts.

If through the daily cash settlement process, losses in the account of a security futures contract participant reduce the funds on deposit (or equity) below the maintenance margin level (or the firm’s higher “house” requirement), the brokerage firm will require that additional funds be deposited.

If additional margin is not deposited in accordance with the firm’s policies, the firm can liquidate your position in security futures contracts or sell assets in any of your accounts at the firm to cover the margin deficiency. You remain responsible for any shortfall in the account after such liquidations or sales. Unless provided otherwise in

your customer agreement or by applicable law, you are not entitled to choose which futures contracts, other securities or other assets are liquidated or sold to meet a margin call or to obtain an extension of time to meet a margin call.

Brokerage firms generally reserve the right to liquidate a customer's security futures contract positions or sell customer assets to meet a margin call at any time without contacting the customer. Brokerage firms may also enter into equivalent but opposite positions for your account in order to manage the risk created by a margin call. Some customers mistakenly believe that a firm is required to contact them for a margin call to be valid, and that the firm is not allowed to liquidate securities or other assets in their accounts to meet a margin call unless the firm has contacted them first. This is not the case. While most firms notify their customers of margin calls and allow some time for deposit of additional margin, they are not required to do so. Even if a firm has notified a customer of a margin call and set a specific due date for a margin deposit, the firm can still take action as necessary to protect its financial interests, including the immediate liquidation of positions without advance notification to the customer.

Here is an example of the margin requirements for a long security futures position.

A customer buys 3 July EJM security futures at 71.50. Assuming each contract represents 100 shares, the nominal value of the position is \$21,450 ($71.50 \times 3 \text{ contracts} \times 100 \text{ shares}$). If the initial margin rate is 20% of the nominal value, then the customer's initial margin requirement would be \$4,290. The customer deposits the initial margin, bringing the equity in the account to \$4,290.

First, assume that the next day the settlement price of EJJ security futures falls to 69.25. The marked-to-market loss in the customer's equity is \$675 ($71.50 - 69.25 \times 3$ contracts \times 100 shares). The customer's equity decreases to \$3,615 ($\$4,290 - \675). The new nominal value of the contract is \$20,775 (69.25×3 contracts \times 100 shares). If the maintenance margin rate is 20% of the nominal value, then the customer's maintenance margin requirement would be \$4,155. Because the customer's equity had decreased to \$3,615 (see above), the customer would be required to have an additional \$540 in margin ($\$4,155 - \$3,615$).

Alternatively, assume that the next day the settlement price of EJJ security futures rises to 75.00. The mark-to-market gain in the customer's equity is \$1,050 ($75.00 - 71.50 \times 3$ contracts \times 100 shares). The customer's equity increases to \$5,340 ($\$4,290 + \$1,050$). The new nominal value of the contract is \$22,500 (75.00×3 contracts \times 100 shares). If the maintenance margin rate is 20% of the nominal value, then the customer's maintenance margin requirement would be \$4,500. Because the customer's equity had increased to \$5,340 (see above), the customer's excess equity would be \$840.

The process is exactly the same for a short position, except that margin calls are generated as the settlement price rises rather than as it falls. This is because the customer's equity decreases as the settlement price rises and increases as the settlement price falls.

Because the margin deposit required to open a security futures position is a fraction of the nominal value of the contracts being purchased or sold, security futures contracts are said to be highly leveraged. The smaller the margin requirement in relation to the underlying value of the security futures contract, the greater the leverage.

Leverage allows exposure to a given quantity of an underlying asset for a fraction of the investment needed to purchase that quantity outright. In sum, buying (or selling) a security futures contract provides the same dollar and cents profit and loss outcomes as owning (or shorting) the underlying security. However, as a percentage of the margin deposit, the potential immediate exposure to profit or loss is much higher with a security futures contract than with the underlying security.

For example, if a security futures contract is established at a price of \$50, the contract has a nominal value of \$5,000 (assuming the contract is for 100 shares of stock). The margin requirement may be as low as 20%. In the example just used, assume the contract price rises from \$50 to \$52 (a \$200 increase in the nominal value). This represents a \$200 profit to the buyer of the security futures contract, and a 20% return on the \$1,000 deposited as margin. The reverse would be true if the contract price decreased from \$50 to \$48. This represents a \$200 loss to the buyer, or 20% of the \$1,000 deposited as margin. Thus, leverage can either benefit or harm an investor.

Note that a 4% decrease in the value of the contract resulted in a loss of 20% of the margin deposited. A 20% decrease would wipe out 100% of the margin deposited on the security futures contract.

Section 5 – Settlement

If you do not liquidate your position prior to the end of trading on the last day before the expiration of the security futures contract, you are obligated to either 1) make or accept a cash payment (“cash settlement”) or 2) deliver or accept delivery of the underlying securities in exchange for final payment of the final settlement price

(“physical delivery”). The terms of the contract dictate whether it is settled through cash settlement or by physical delivery.

The expiration of a security futures contract is established by the exchange on which the contract is listed. On the expiration day, security futures contracts cease to exist. Typically, the last trading day of a security futures contract will be the third Friday of the expiring contract month, and the expiration day will be the following Saturday. This follows the expiration conventions for stock options and broad-based stock indexes. Please keep in mind that the expiration day is set by the listing exchange and may deviate from these norms.

5.1. Cash settlement

In the case of cash settlement, no actual securities are delivered at the expiration of the security futures contract. Instead, you must settle any open positions in security futures by making or receiving a cash payment based on the difference between the final settlement price and the previous day’s settlement price. Under normal circumstances, the final settlement price for a cash-settled contract will reflect the opening price for the underlying security. Once this payment is made, neither the buyer nor the seller of the security futures contract has any further obligations on the contract.

5.2. Settlement by physical delivery

Settlement by physical delivery is carried out by clearing brokers or their agents with National Securities Clearing Corporation (NSCC), an SEC-regulated securities clearing agency. Such settlements are made in much the same way as they are for purchases and sales of the underlying security. Promptly after the last day of trading, the regulated exchange’s clearing organization will report a purchase and sale of the

underlying stock at the previous day's settlement price (also referred to as the "invoice price") to NSCC. In general, if NSCC does not reject the transaction by a time specified in its rules, settlement is effected pursuant to the rules of the exchange and NSCC's Rules and Procedures within the normal clearance and settlement cycle for securities transactions, which currently is two business days. However, settlement may be effected on a shorter timeframe based on the rules of the exchange and subject to NSCC's Rules and Procedures.

If you hold a short position in a physically settled security futures contract to expiration, you will be required to make delivery of the underlying securities. If you already own the securities, you may tender them to your brokerage firm. If you do not own the securities, you will be obligated to purchase them. Some brokerage firms may not be able to purchase the securities for you. If your brokerage firm cannot purchase the underlying securities on your behalf to fulfill a settlement obligation, you will have to purchase the securities through a different firm.

Section 6 – Customer Account Protections

Positions in security futures contracts may be held either in a securities account or in a futures account. Your brokerage firm may or may not permit you to choose the types of account in which your positions in security futures contracts will be held. The protections for funds deposited or earned by customers in connection with trading in security futures contracts differ depending on whether the positions are carried in a securities account or a futures account. If your positions are carried in a securities account, you will not receive the protections available for futures accounts. Similarly, if your positions are carried in a futures account, you will not receive the protections

available for securities accounts. You should ask your broker which of these protections will apply to your funds.

You should be aware that the regulatory protections applicable to your account are not intended to insure you against losses you may incur as a result of a decline or increase in the price of a security futures contract. As with all financial products, you are solely responsible for any market losses in your account.

Your brokerage firm must tell you whether your security futures positions will be held in a securities account or a futures account. If your brokerage firm gives you a choice, it must tell you what you have to do to make the choice and which type of account will be used if you fail to do so. You should understand that certain regulatory protections for your account will depend on whether it is a securities account or a futures account.

6.1. Protections for Securities Accounts

If your positions in security futures contracts are carried in a securities account, they are covered by SEC rules governing the safeguarding of customer funds and securities. These rules prohibit a broker-dealer from using customer funds and securities to finance its business. As a result, the broker-dealer is required to set aside funds equal to the net of all its excess payables to customers over receivables from customers. The rules also require a broker-dealer to segregate all customer fully paid and excess margin securities carried by the broker-dealer for customers.

The Securities Investor Protection Corporation (SIPC) also covers positions held in securities accounts. SIPC was created in 1970 as a non-profit, non-government, membership corporation, funded by member broker-dealers. Its primary role is to return

funds and securities to customers if the broker-dealer holding these assets becomes insolvent. SIPC coverage applies to customers of current (and in some cases former) SIPC members. Most broker-dealers registered with the SEC are SIPC members; those few that are not must disclose this fact to their customers. SIPC members must display an official sign showing their membership. To check whether a firm is a SIPC member, go to www.sipc.org, call the SIPC Membership Department at (202) 371-8300, or write to SIPC Membership Department, Securities Investor Protection Corporation, 1667 K Street, NW, Suite 1000, Washington, DC 20006-1620.

SIPC coverage is limited to \$500,000 per customer, including up to \$100,000 for cash. For example, if a customer has 1,000 shares of XYZ stock valued at \$200,000 and \$10,000 cash in the account, both the security and the cash balance would be protected. However, if the customer has shares of stock valued at \$500,000 and \$100,000 in cash, only a total of \$500,000 of those assets will be protected.

For purposes of SIPC coverage, customers are persons who have securities or cash on deposit with a SIPC member for the purpose of, or as a result of, securities transactions. SIPC does not protect customer funds placed with a broker-dealer just to earn interest. Insiders of the broker-dealer, such as its owners, officers, and partners, are not customers for purposes of SIPC coverage.

6.2. Protections for Futures Accounts

If your security futures positions are carried in a futures account, they must be segregated from the brokerage firm's own funds and cannot be borrowed or otherwise used for the firm's own purposes. If the funds are deposited with another entity (e.g., a bank, clearing broker, or clearing organization), that entity must acknowledge that the

funds belong to customers and cannot be used to satisfy the firm's debts. Moreover, although a brokerage firm may carry funds belonging to different customers in the same bank or clearing account, it may not use the funds of one customer to margin or guarantee the transactions of another customer. As a result, the brokerage firm must add its own funds to its customers' segregated funds to cover customer debits and deficits. Brokerage firms must calculate their segregation requirements daily.

You may not be able to recover the full amount of any funds in your account if the brokerage firm becomes insolvent and has insufficient funds to cover its obligations to all of its customers. However, customers with funds in segregation receive priority in bankruptcy proceedings. Furthermore, all customers whose funds are required to be segregated have the same priority in bankruptcy, and there is no ceiling on the amount of funds that must be segregated for or can be recovered by a particular customer.

Your brokerage firm is also required to separately maintain funds invested in security futures contracts traded on a foreign exchange. However, these funds may not receive the same protections once they are transferred to a foreign entity (e.g., a foreign broker, exchange or clearing organization) to satisfy margin requirements for those products. You should ask your broker about the bankruptcy protections available in the country where the foreign exchange (or other entity holding the funds) is located.

Section 7 – Special Risks for Day Traders

Certain traders who pursue a day trading strategy may seek to use security futures contracts as part of their trading activity. Whether day trading in security futures

contracts or other securities, investors engaging in a day trading strategy face a number of risks.

- ***Day trading in security futures contracts requires in-depth knowledge of the securities and futures markets and of trading techniques and strategies.*** In attempting to profit through day trading, you will compete with professional traders who are knowledgeable and sophisticated in these markets. You should have appropriate experience before engaging in day trading.
- ***Day trading in security futures contracts can result in substantial commission charges, even if the per trade cost is low.*** The more trades you make, the higher your total commissions will be. The total commissions you pay will add to your losses and reduce your profits. For instance, assuming that a round-turn trade costs \$16 and you execute an average of 29 round-turn transactions per day each trading day, you would need to generate an annual profit of \$111,360 just to cover your commission expenses.
- ***Day trading can be extremely risky.*** Day trading generally is not appropriate for someone of limited resources and limited investment or trading experience and low risk tolerance. You should be prepared to lose all of the funds that you use for day trading. In particular, you should not fund day trading activities with funds that you cannot afford to lose.

Section 8 – Other

8.1. Corporate Events

As noted in Section 2.4, an equity security represents a fractional ownership interest in the issuer of that security. By contrast, the purchaser of a security futures

contract has only a contract for future delivery of the underlying security. Treatment of dividends and other corporate events affecting the underlying security may be reflected in the security futures contract depending on the applicable clearing organization rules. Consequently, individuals should consider how dividends and other developments affecting security futures in which they transact will be handled by the relevant exchange and clearing organization. The specific adjustments to the terms of a security futures contract are governed by the rules of the applicable clearing organization. Below is a discussion of some of the more common types of adjustments that you may need to consider.

Corporate issuers occasionally announce stock splits. As a result of these splits, owners of the issuer's common stock may own more shares of the stock, or fewer shares in the case of a reverse stock split. The treatment of stock splits for persons owning a security futures contract may vary according to the terms of the security futures contract and the rules of the clearing organization. For example, the terms of the contract may provide for an adjustment in the number of contracts held by each party with a long or short position in a security future, or for an adjustment in the number of shares or units of the instrument underlying each contract, or both.

Corporate issuers also occasionally issue special dividends. A special dividend is an announced cash dividend payment outside the normal and customary practice of a corporation. The terms of a security futures contract may be adjusted for special dividends. The adjustments, if any, will be based upon the rules of the exchange and clearing organization. In general, there will be no adjustments for ordinary dividends as they are recognized as a normal and customary practice of an issuer and are already

accounted for in the pricing of security futures. However, adjustments for ordinary dividends may be made for a specified class of security futures contracts based on the rules of the exchange and the clearing organization.

Corporate issuers occasionally may be involved in mergers and acquisitions. Such events may cause the underlying security of a security futures contract to change over the contract duration. The terms of security futures contracts may also be adjusted to reflect other corporate events affecting the underlying security.

8.2. Position Limits and Large Trader Reporting

All security futures contracts trading on regulated exchanges in the United States are subject to position limits or position accountability limits. Position limits restrict the number of security futures contracts that any one person or group of related persons may hold or control in a particular security futures contract. In contrast, position accountability limits permit the accumulation of positions in excess of the limit without a prior exemption. In general, position limits and position accountability limits are beyond the thresholds of most retail investors. Whether a security futures contract is subject to position limits, and the level for such limits, depends upon the trading activity and market capitalization of the underlying security of the security futures contract.

Position limits are required for security futures contracts [that overlie]on a security [that has an average daily trading volume of 20 million shares or fewer]. [In the case of a security futures contract overlying a security index, position limits are required if any one of the securities in the index has an average daily trading volume of 20 million shares or fewer.] Position limits also apply only to an expiring security futures contract during its last [five]three trading days. A regulated exchange must establish a default

position limit[s] on a security futures contract that [are]is no greater than [13,500]25,000 [(100-share)] contracts (or the equivalent if the contract size is different than 100 shares), either net or on the same side of the market, unless the underlying security [meets certain volume and shares outstanding thresholds]exceeds 20 million shares of estimated deliverable supply, in which case the limit may be [increased to 22,500 (100 share) contracts]set at a level no greater than 12.5 percent of the estimated deliverable supply of the underlying security, either net or on the same side of the market.

For a security futures contract[s] [overlying]on a security [or securities] with [an average]a six-month total trading volume of more than [20 million]2.5 billion shares and there are more than 40 million shares of estimated deliverable supply, a regulated exchange[s] may adopt a position accountability rule[s] in lieu of a position limit, either net or on the same side of the market. Under position accountability rules, a trader holding a position in a security futures contract that exceeds [22,500]25,000 100-share contracts (or [such lower limit established by an exchange]the equivalent if the contract size is different than 100 shares) or such lower level specified under the rules of the exchange, must agree to provide information regarding the position and consent to halt increasing that position if requested by the exchange.

Brokerage firms must also report large open positions held by one person (or by several persons acting together) to the CFTC as well as to the exchange on which the positions are held. The CFTC's reporting requirements are 1,000 contracts for security futures positions on individual equity securities and 200 contracts for positions on a narrow-based index. However, individual exchanges may require the reporting of large open positions at levels less than the levels required by the CFTC. In addition, brokerage

firms must submit identifying information on the account holding the reportable position (on a form referred to as either an “Identification of Special Accounts Form” or a “Form 102”) to the CFTC and to the exchange on which the reportable position exists [within three business days of]no later than the following business day when a reportable position is first established.

8.3. Transactions on Foreign Exchanges

U.S. customers may not trade security futures on foreign exchanges until authorized by U.S. regulatory authorities. U.S. regulatory authorities do not regulate the activities of foreign exchanges and may not, on their own, compel enforcement of the rules of a foreign exchange or the laws of a foreign country. While U.S. law governs transactions in security futures contracts that are effected in the U.S., regardless of the exchange on which the contracts are listed, the laws and rules governing transactions on foreign exchanges vary depending on the country in which the exchange is located.

8.4. Tax Consequences

For most taxpayers, security futures contracts are not treated like other futures contracts. Instead, the tax consequences of a security futures transaction depend on the status of the taxpayer and the type of position (e.g., long or short, covered or uncovered). Because of the importance of tax considerations to transactions in security futures, readers should consult their tax advisors as to the tax consequences of these transactions.

Section 9 – Glossary of Terms

This glossary is intended to assist customers in understanding specialized terms used in the futures and securities industries. It is not inclusive and is not intended to state or suggest the legal significance or meaning of any word or term.

Arbitrage – taking an economically opposite position in a security futures contract on another exchange, in an options contract, or in the underlying security.

Broad-based security index – a security index that does not fall within the statutory definition of a narrow-based security index (see Narrow-based security index). A future on a broad-based security index is not a security future. This risk disclosure statement applies solely to security futures and generally does not pertain to futures on a broad-based security index. Futures on a broad-based security index are under exclusive jurisdiction of the CFTC.

Cash settlement – a method of settling certain futures contracts by having the buyer (or long) pay the seller (or short) the cash value of the contract according to a procedure set by the exchange.

Clearing broker – a member of the clearing organization for the contract being traded. All trades, and the daily profits or losses from those trades, must go through a clearing broker.

Clearing organization – a regulated entity that is responsible for settling trades, collecting losses and distributing profits, and handling deliveries.

Contract – 1) the unit of trading for a particular futures contract (e.g., one contract may be 100 shares of the underlying security), 2) the type of future being traded (e.g., futures on ABC stock).

Contract month – the last month in which delivery is made against the futures contract or the contract is cash-settled. Sometimes referred to as the delivery month.

Day trading strategy – an overall trading strategy characterized by the regular transmission by a customer of intra-day orders to effect both purchase and sale transactions in the same security or securities.

EDGAR – the SEC’s Electronic Data Gathering, Analysis, and Retrieval system maintains electronic copies of corporate information filed with the agency. EDGAR submissions may be accessed through the SEC’s Web site, www.sec.gov.

Futures contract – a futures contract is (1) an agreement to purchase or sell a commodity for delivery in the future; (2) at a price determined at initiation of the contract; (3) that obligates each party to the contract to fulfill it at the specified price; (4) that is used to assume or shift risk; and (5) that may be satisfied by delivery or offset.

Hedging – the purchase or sale of a security future to reduce or offset the risk of a position in the underlying security or group of securities (or a close economic equivalent).

Illiquid market – a market (or contract) with few buyers and/or sellers. Illiquid markets have little trading activity and those trades that do occur may be done at large price increments.

Liquidation – entering into an offsetting transaction. Selling a contract that was previously purchased liquidates a futures position in exactly the same way that selling 100 shares of a particular stock liquidates an earlier purchase of the same stock. Similarly, a futures contract that was initially sold can be liquidated by an offsetting purchase.

Liquid market – a market (or contract) with numerous buyers and sellers trading at small price increments.

Long – 1) the buying side of an open futures contract, 2) a person who has bought futures contracts that are still open.

Margin – the amount of money that must be deposited by both buyers and sellers to ensure performance of the person’s obligations under a futures contract. Margin on security futures contracts is a performance bond rather than a down payment for the underlying securities.

Mark-to-market – to debit or credit accounts daily to reflect that day’s profits and losses.

Narrow-based security index – in general, and subject to certain exclusions, an index that has any one of the following four characteristics: (1) it has nine or fewer component securities; (2) any one of its component securities comprises more than 30% of its weighting; (3) the five highest weighted component securities together comprise more than 60% of its weighting; or (4) the lowest weighted component securities comprising, in the aggregate, 25% of the index’s weighting have an aggregate dollar value of average daily trading volume of less than \$50 million (or in the case of an index with 15 or more component securities, \$30 million). A security index that is not narrow-based is a “broad based security index.” (See Broad-based security index).

Nominal value – the face value of the futures contract, obtained by multiplying the contract price by the number of shares or units per contract. If XYZ stock index futures are trading at \$50.25 and the contract is for 100 shares of XYZ stock, the nominal value of the futures contract would be \$5025.00.

Offsetting – liquidating open positions by either selling fungible contracts in the same contract month as an open long position or buying fungible contracts in the same contract month as an open short position.

Open interest – the total number of open long (or short) contracts in a particular contract month.

Open position – a futures contract position that has neither been offset nor closed by cash settlement or physical delivery.

Performance bond – another way to describe margin payments for futures contracts, which are good faith deposits to ensure performance of a person's obligations under a futures contract rather than down payments for the underlying securities.

Physical delivery – the tender and receipt of the actual security underlying the security futures contract in exchange for payment of the final settlement price.

Position – a person's net long or short open contracts.

Regulated exchange – a registered national securities exchange, a national securities association registered under Section 15A(a) of the Securities Exchange Act of 1934, a designated contract market, a registered derivatives transaction execution facility, or an alternative trading system registered as a broker or dealer.

Security futures contract – a legally binding agreement between two parties to purchase or sell in the future a specific quantity of shares of a security (such as common stock, an exchange-traded fund, or ADR) or a narrow-based security index, at a specified price.

Settlement price – 1) the daily price that the clearing organization uses to mark open positions to market for determining profit and loss and margin calls, 2) the price at which

open cash settlement contracts are settled on the last trading day and open physical delivery contracts are invoiced for delivery.

Short – 1) the selling side of an open futures contract, 2) a person who has sold futures contracts that are still open.

Speculating – buying and selling futures contracts with the hope of profiting from anticipated price movements.

Spread – 1) holding a long position in one futures contract and a short position in a related futures contract or contract month in order to profit from an anticipated change in the price relationship between the two, 2) the price difference between two contracts or contract months.

Stop limit order – an order that becomes a limit order when the market trades at a specified price. The order can only be filled at the stop limit price or better.

Stop loss order – an order that becomes a market order when the market trades at a specified price. The order will be filled at whatever price the market is trading at. Also called a stop order.

Tick – the smallest price change allowed in a particular contract.

Trader – a professional speculator who trades for his or her own account.

Underlying security – the instrument on which the security futures contract is based.

This instrument can be an individual equity security (including common stock and certain exchange-traded funds and American Depositary Receipts) or a narrow-based index.

Volume – the number of contracts bought or sold during a specified period of time. This figure includes liquidating transactions.

2020 Supplement to the Security Futures Risk Disclosure Statement

The 2018 Security Futures Risk Disclosure Statement is amended as provided below.

The first paragraph of the Introduction is replaced with the following paragraph:

This disclosure statement discusses the characteristics and risks of standardized security futures contracts traded on regulated U.S. exchanges. At present, regulated exchanges are authorized to list futures contracts on individual equity securities registered under the Securities Exchange Act of 1934 (including common stock and certain exchange-traded funds and American Depositary Receipts), futures on certain debt instruments as well as narrow-based security indices. Futures on other types of securities and options on security futures contracts may be authorized in the future. The glossary of terms appears at the end of the document.

* * * * *

The first paragraph under Section 2.7 (Trading Halts) is replaced with the following paragraph:

The value of your positions in security futures contracts could be affected if trading is halted in either the security futures contract or the underlying security. In certain circumstances, regulated exchanges are required by

law to halt trading in security futures contracts. For example, trading on a particular security futures contract must be halted if trading is halted on the listed market for the underlying security as a result of pending news, regulatory concerns, or market volatility. Similarly, trading of a security futures contract on a narrow-based security index must be halted under such circumstances if trading is halted on securities accounting for at least 50 percent of the market capitalization of the index. In addition, regulated exchanges are required to halt trading in all security futures contracts for a specified period of time when the S&P 500 Index experiences one-day declines of seven-, 13- and 20-percent. The regulated exchanges may also have discretion under their rules to halt trading in other circumstances – such as when the exchange determines that the halt would be advisable in maintaining a fair and orderly market.

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The second, third, and fourth paragraphs under Section 8.2 (Position Limits and Large Trader Reporting) are replaced with the following paragraphs:

Position limits are required for security futures contracts on a security. Position limits also apply only to an expiring security futures contract during its last three trading days. A regulated exchange must establish a

default position limit on a security futures contract that is no greater than 25,000 100-share contracts (or the equivalent if the contract size is different than 100 shares), either net or on the same side of the market, unless the underlying security exceeds 20 million shares of estimated deliverable supply, in which case the limit may be set at a level no greater than 12.5 percent of the estimated deliverable supply of the underlying security, either net or on the same side of the market.

For a security futures contract on a security with a six-month total trading volume of more than 2.5 billion shares and there are more than 40 million shares of estimated deliverable supply, a regulated exchange may adopt a position accountability rule in lieu of a position limit, either net or on the same side of the market. Under position accountability rules, a trader holding a position in a security futures contract that exceeds 25,000 100-share contracts (or the equivalent if the contract size is different than 100 shares) or such lower level specified under the rules of the exchange, must agree to provide information regarding the position and consent to halt increasing that position if requested by the exchange.

Brokerage firms must also report large open positions held by one person (or by several persons acting together) to the CFTC as well as to the exchange on which the positions are held. The CFTC's reporting requirements are 1,000 contracts for security futures positions on individual equity securities and 200 contracts for positions on a narrow-based index. However, individual exchanges may require the reporting of large open positions at levels less than the levels required by the CFTC. In addition, brokerage firms must submit identifying information on the account holding the reportable position (on a form referred to as either an "Identification of Special Accounts Form" or a "Form 102") to the CFTC and to the exchange on which the reportable position exists no later than the following business day when a reportable position is first established.