Regulatory Notice 21-11

Margin Requirements

FINRA Requests Comment on Proposed Amendments to the Margin Rule Regarding When Issued and Other Extended Settlement Transactions

Comment Period Expires: May 14, 2021

Summary

FINRA seeks comment on proposed amendments to Rule 4210 (Margin Requirements) that would clarify and incorporate into the rule current interpretations regarding when issued and other extended settlement transactions, and provide relief to facilitate the application of the rule to these transactions.

The proposed rule text marked to show changes from the current rule text is available in Attachment A.

Two additional attachments are included to assist in the review of the proposed amendments. Attachment B consists of examples illustrating the operation of the rule under the proposed amendments. Attachment C is a flow chart outlining an analysis of the application of the proposed rule to these transactions. Attachments B and C are included for illustrative purposes only.

Questions regarding this *Notice* should be directed to:

- Kris Dailey, Vice President, Regulatory Development Services, Office of Financial and Operational Risk Policy (OFORP), at (646) 315-8434 or kris.dailey@finra.org;
- James Barry, Director, Credit Regulation, OFORP, at (646) 315-8347 or james.barry@finra.org;
- David Aman, Senior Advisor, OFORP, at (212) 416-1544 or david.aman@finra.org; or
- Kathryn Moore, Associate General Counsel, Office of General Counsel, at (202) 728-8200 or kathryn.moore@finra.org.

Questions concerning the Economic Impact Assessment in this *Notice* should be directed to:

- Dror Kenett, Economist, Office of the Chief Economist, at (202) 728-8208 or Dror.Kenett@finra.org.

FINRA

March 15, 2021

Notice Type

- Request for Comment

Suggested Routing

- Compliance
- Legal
- Margin
- Operations
- Registered Representative
- Risk
- Senior Management
- Systems

Key Topics

- DVP accounts
- Extended Settlement Transactions
- Margin
- When Issued Securities

Referenced Rules

- FINRA Rule 4210
- FINRA Rule 11860
- Regulatory Notice 16-31
- SEA Rule 15c6-1
- Section 220.8 of Regulation T

Action Requested

FINRA encourages all interested parties to comment. Comments must be received by May 14, 2021.

Comments must be submitted through one of the following methods:

- Online using FINRA's comment form for this *Notice*;
- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

  Jennifer Piorko Mitchell
  Office of the Corporate Secretary
  FINRA
  1735 K Street, NW
  Washington, DC 20006-1506

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

Important Notes: Comments received in response to *Regulatory Notices* will be made available to the public on the FINRA website. In general, comments will be posted as they are received.[1]

Before becoming effective, a proposed rule change must be filed with the Securities and Exchange Commission (SEC) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).[2]

Background and Discussion

A. Extended Settlement Transactions; Definition and General Rule

Rule 4210 protects member firms against customer credit risk by generally requiring firms to collect margin when they extend credit to their customers. Extensions of credit covered by the rule include transactions in which member firms permit customers to make partial or delayed payment on securities purchases (or partial or delayed delivery of securities sold).

FINRA examinations have revealed some uncertainty in firms' understanding about what constitutes delayed payment or delivery for purposes of the margin rules. This uncertainty regarding whether a payment or delivery should be considered delayed may be due in part to the fact that Federal Reserve Board (FRB) Regulation T allows transactions to be booked into a customer's cash account based on the customer's agreement to make full cash payment for securities purchased (or deposit securities sold) *promptly* (*i.e.,* within the

standard settlement cycle),[3] but then allows two additional business days to resolve any issues with a customer's payment[4] before requiring a broker-dealer to cancel or liquidate the customer's purchase of non-exempted securities (or obtain an extension of time).

FINRA believes that it is important to have a clear and uniform standard to eliminate this uncertainty regarding whether a payment or delivery is considered delayed. FINRA therefore proposes to define "extended settlement transaction" as:

> any contract for the purchase or sale of a security (including any exempted security) that does not provide for the payment of funds by the customer (in the case of a customer purchase) or delivery of securities by the customer (in the case of a customer sale) by the second business day after the date of the contract.

In addition, FINRA proposes to add a new paragraph (f)(3)(C) to Rule 4210 requiring all extended settlement transactions (or net positions resulting from extended settlement transactions) to be margined as though they were in margin accounts, except for the specifically excepted transactions or positions described below.

Classification of a purchase or sale of a security as an "extended settlement transaction" depends on when the customer is **required** to make payment or delivery under the terms of the member firm's contract with the customer, **not** on when the customer actually makes payment or delivery, and **not** on the stated "settlement date" for the transaction. In this respect, the definition resembles the requirement that, in order for a broker-dealer to book a transaction in a customer's Regulation T cash account, the broker-dealer must accept *in good faith* the customer's agreement that the customer will promptly make full cash payment (or that the security will be promptly deposited into the account). The following examples demonstrate this principle.

- If a customer purchases a security and agrees to make full cash payment by T+2, but an unexpected issue prevents the customer from making payment until the following day, the transaction **would not** be an "extended settlement transaction" because the broker-dealer accepted in good faith the customer's agreement to pay. However, it would have been an extended settlement transaction if the firm had agreed in advance to allow the customer to delay payment until T+3.
- Similarly, if a customer's purchase transaction has a stated settlement date of T+5 and the customer is not required to make full cash payment prior to the settlement date, the transaction would be an extended settlement transaction. However, if the customer agrees to make full cash payment by T+2 (even though that is prior to the stated settlement date of the transaction), the transaction would not be an "extended settlement transaction."[5]

- On the other hand, if a customer purchases a security in a transaction with a stated settlement date of T+2, but the firm does not have a good faith belief that the customer will make full cash payment by that date (including if the firm agrees expressly or tacitly, orally or in writing, that the customer is not required to pay until after T+2), then the transaction would be an extended settlement transaction. The firm cannot "cure" a delay by the customer to pay for a security by agreeing for payment on a later date. Such a transaction remains an extended settlement transaction.

B. Extended Settlement Transactions; Exceptions to the General Rule

As stated above, proposed new Rule 4210(f)(3)(C) would require all extended settlement transactions (or net positions resulting from extended settlement transactions) to be margined as though they were in margin accounts, except for the following specified transactions or positions:

1. **Covered Agency Transactions.** Margining of Covered Agency Transactions is addressed by paragraph (e)(2)(H) of Rule 4210.[6] Accordingly, FINRA is proposing to add a new paragraph (f)(3)(D) to except Covered Agency Transactions from the requirements of paragraph (f)(3) since they may also be extended settlement transactions or when issued transactions. In the interest of aligning with the approach of Rule 4210(e)(2)(H), FINRA proposes to also except transactions in agency Collateralized Mortgage Obligations (CMOs) for T+3 settlement from Rule 4210(f)(3) even though, due to the timing of settlement, they are not Covered Agency Transactions as defined for purposes of paragraph (e)(2)(H).[7]
2. **When Issued Security Transactions.** Transactions or net positions resulting from contracts in when issued securities are excepted from proposed Rule 4210(f)(3)(C) because they are specifically addressed by Rule 4210(f)(3)(A) and (B). *See* below for discussion of the proposed amendments to those provisions.
3. **Certain Refunding Transactions.** An exception from proposed Rule 4210(f)(3)(C) is provided for any purchase of a new refunding security that is made no more than 35 calendar days prior to the date of maturity or redemption of an old security of the same issuer that is held in the customer's cash account, provided that the purchase is for an amount that does not exceed 103 percent of the proceeds of the old security. This exception is consistent with Section 220.8(b)(i)(D) of Regulation T, with the added requirement that the old security be held in the customer's cash account. This added requirement protects the member firm against the risk that the proceeds of the maturity or redemption of the old security would not be deposited into the account to pay for the purchase of the new refunding security.
4. **Settlement Extended Due to the Mechanics of a Transaction With a Bona Fide DVP Customer.** An exception from proposed Rule 4210(f)(3)(C) is provided for any extended settlement transaction in the cash account of a "bona fide DVP customer" if delivery is delayed not more than 35 calendar days after the trade date due to the mechanics

of the transaction, and not the customer's willingness or ability to pay.[8] FINRA proposes this exception (and a similar exception described below in the discussion of transactions in when issued securities) to facilitate application of the rule to bona fide DVP customers. Firms generally cannot obtain margin from these customers because DVP arrangements are established by customers who either are not legally allowed to, or elect not to, entrust their assets to the firm. Since the settlement delays still create credit risk, the proposed amendments would require firms to cover that risk by taking a net capital charge for any margin not collected based on this exception.

This exception is only applicable to transactions in the cash account of a "bona fide DVP customer," which FINRA proposes to define as a customer with whom the member firm has a payment on delivery (POD)/collect on delivery (COD) arrangement that satisfies the requirements of FINRA Rule 11860, and, to the extent applicable, provides for prompt affirmation of any non-depository eligible transactions.[9]

C. Transactions in When Issued Securities

Transactions in when issued securities[10] are a type of extended settlement transaction that are specifically covered in Rule 4210(f)(3), even if they are recorded in a customer's cash account. Currently, margin account transactions in when issued securities are generally subject to the same margin requirements as transactions in issued securities (except that unrealized profits on a position in a when issued security are only of value in satisfying the margin requirement on that position). Cash account transactions in when issued securities are generally subject to the same margin requirements as margin account transactions (subject to exceptions set out in current Rule 4210(f)(3)(B)). FINRA proposes to reorganize the when issued provisions of Rule 4210(f)(3) to reduce confusion, clarify the scope of the public offering exception, and facilitate the practical application of the rule by allowing member firms to take capital charges in lieu of collecting margin on when issued transactions in cash accounts of exempt account and bona fide DVP customers.

1. **The Scope of the Public Offering Exception.** FINRA Rule 4210(f)(3) currently states that it does not apply to positions resulting from "contracts on a 'when issued' basis in a security which is the subject of a primary distribution in connection with a bona fide offering by the issuer to the general public for 'cash'." This exception was intended to exclude from the rule initial public offerings (IPOs) of equity securities on a when issued basis. Although FINRA staff has interpreted the scope of this exception consistent with that intention, some member firms have cited this exception as a justification for failing to collect margin on when issued transactions in non-equity securities, or on transactions in when issued transactions in equity securities offered in secondary, follow-on or exchange offerings. FINRA proposes to restate this exception so that it is expressly limited to equity IPOs[11] and simultaneously offer relief by creating new exceptions for U.S. Treasury and municipal securities, and to allow firms to take capital charges in lieu of collecting margin from certain customers.

2. **New Exceptions for U.S. Treasury and Municipal Securities.** In clarifying the scope of the public offering exception, FINRA recognizes that firms have often understood the original language of the rule to except new issuances of U.S. Treasury securities and municipal securities from margin requirements. FINRA believes these transactions present low risks relative to other non-equity offerings and proposes new exceptions to avoid disruptions to these markets. The new provisions would except from the margin requirements when issued transactions in cash accounts in any U.S. Treasury security scheduled to be issued by the 14th calendar day after the trade date and in any municipal security scheduled to be issued by the 42nd calendar day after the trade date.[12] FINRA believes these exceptions would have applied to all recent U.S. Treasury securities issuances and substantially all recent municipal securities issuances.
3. **Capital Charges in Lieu of Collecting Margin From Exempt Accounts and Bona Fide DVP Customers.** Member firms have frequently cited the difficulty in collecting margin on when issued transactions with certain institutional customers, especially DVP customers who are unable to deposit margin with the firm, as a reason for expansively interpreting the public offering exception or for amending the rule to except from the rule's requirements when issued transactions with certain institutional customers. FINRA understands these difficulties and does not want Rule 4210 to interfere with sales to these customers. At the same time, FINRA believes that these transactions expose member firms to credit risk against which they must protect themselves. Accordingly, rather than excepting these transactions from the rule's requirements completely, FINRA proposes the following exceptions to allow member firms not to collect margin from these customers provided that they take capital charges for their credit risk.
    a. **Exempt Accounts and Non-Member Broker-Dealers.** Rule 4210(f)(3)(B) currently allows member firms to take capital charges for any net mark to market loss on transactions or net positions in when issued securities in cash accounts of FINRA members or designated accounts,[13] in lieu of collecting margin on those positions. It also allows member firms to collect margin only for any net mark to market loss on transactions or net positions in when issued securities in cash accounts of non-member broker-dealers, including foreign broker-dealers. FINRA staff has interpreted the exception for designated accounts to be available for any customer that is an "exempt account," a category that includes designated accounts, broker-dealers registered under the Exchange Act (whether or not FINRA members) and certain other institutional customers.[14] FINRA proposes to incorporate this interpretation into the rule and also apply it to any non-member broker-dealer, which includes foreign broker-dealers.
    b. **Bona Fide DVP Customers.** Many DVP customers are also exempt accounts that would be covered by the exception described above. However, some DVP customers are not able to qualify as exempt accounts or otherwise have not been classified as exempt accounts even if they do qualify. To facilitate the practical application

of the rule to these DVP customers, while ensuring member firms are protected against the credit risk inherent in the extended settlement, FINRA proposes a new exception that would allow member firms not to collect margin from bona fide DVP customers on when issued transactions in their cash accounts, provided that the member firms take capital charges for the amount of the margin they would be otherwise required to collect.

4. **Covered Agency Transactions.** As noted above, margining of Covered Agency Transactions is addressed by paragraph (e)(2)(H) of Rule 4210. FINRA is proposing to add a new paragraph (f)(3)(D) that would except Covered Agency Transactions and transactions in agency CMOs for T+3 settlement from Rule 4210(f)(3).

D. Limitation on Capital Charges Taken in Lieu of Collecting Margin.

Rule 4210(e)(2)(I) prescribes limits on net capital deductions. In part, the rule limits the amount of capital charges a member firm may take in lieu of collecting margin for transactions in certain nonequity securities. These capital limits are 5 percent of the member firm's tentative net capital (TNC) for a single account or group of commonly controlled accounts and 25 percent of the member firm's TNC across all accounts.[15] FINRA proposes to codify a current interpretation that these limits apply to all capital charges taken in lieu of collecting margin, including capital charges on when issued transactions and other extended settlement transactions under existing and proposed exceptions from the generally applicable margin requirements.

E. Other Related Clarifications.

The proposed amendments would clarify in the definition of "customer" in FINRA Rule 4210(a)(3) that an extended settlement transaction with a broker-dealer counterparty is subject to Rule 4210's margin requirements, by incorporating into the definition a published interpretation that, when a member firm extends or maintains credit for another broker-dealer, that other broker-dealer is considered a "customer." The proposed revisions would also specify that extensions of credit include extended settlement transactions, repurchase transactions or non-purpose securities borrow transactions. Member firms will continue to be permitted to transact with other registered broker-dealers on a margin basis satisfactory to both parties, provided that a capital charge is taken for the amount of any deficiency between the equity in the account and the haircut requirements under the SEC's net capital rule. FINRA proposes to clarify this treatment in FINRA Rule 4210(e)(6) by adding that the treatment as a customer applies when credit is extended to a broker-dealer.

Finally, the proposed amendments would add supplementary material stating that Regulation T good faith accounts are treated as margin accounts under the rule. After amendments to Regulation T created good faith accounts, the margin rule was amended to include good faith accounts in the scope of the maintenance margin requirements of paragraph (c) but the changes in those amendments were not expressed throughout the rule (including in the when issued section).[16]

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits and transfers of wealth, relative to the current baseline, and the alternatives FINRA considered in assessing how best to meet its regulatory objectives.

Regulatory Need

FINRA, through its examination program, identified that there was some uncertainty as to whether extended settlement starts at T+2 or at a future settlement day. Also, there appears to be need for clarification about whether when issued securities in cash accounts are subject to the same margin requirements as margin account transactions, in accordance with FINRA Rule 4210.

The regulatory uncertainty appears to manifest itself in inconsistent treatment of delayed settlement by firms. Where firms inconsistently provide delayed settlement relief, they may underinvest in related compliance efforts, and undercollect margin, which can increase the risks to the firm. Alternatively, where firms do not provide delayed settlement relief consistently, they may overinvest in related compliance efforts and overcollect margin, affecting the costs and demand for these products. Differential treatment across firms may result in competitive effects, potentially leading to a loss in compliance, supervision and effective management of operational risks.

The proposed amendments to the rule provide clarity around when issued and other extended settlement transactions, and facilitate compliance by member firms by providing the option to take a capital charge in lieu of margin for certain transactions.

Economic Baseline

The economic baseline for the proposed rule amendments includes the relevant sections of FINRA Rule 4210 and the accompanying guidance and interpretations that have been published.[17] These provisions describe and establish the margin requirements for equity and fixed income securities, options, warrants and futures contracts.

The economic baseline also includes the practices identified through the examination program described above. FINRA has used data at its disposal to gain some knowledge about the extent of activities the proposal addresses. With respect to the issue of extended settlement transactions, FINRA analyzed TRACE data to identify transactions that settled at T+3 or longer, in relevant securities. Analysis found that, in an average month during calendar year 2020, 288 member firms had at least one transaction in U.S. Treasury securities with a settlement date after T+2, 115 member firms had at least one transaction in other U.S. government securities (including agency debt, but not agency mortgage-backed securities (MBS)[18]) with a settlement date after T+2, and 688 member firms had at least one transaction in corporate debt securities with a settlement date after T+2. FINRA

currently does not have substantial information regarding the extent of activities in margin or good faith accounts, and is seeking such information, or any other relevant information, through this *Notice* to further evaluate the potential economic impacts of the proposal.

The economic baseline is the benchmark against which to assess the potential impacts of the proposed amendments on FINRA members and investors.

Economic Impacts

FINRA has analyzed the potential costs and benefits of the proposed amendments, and the different parties that are expected to be affected. FINRA has identified member firms that are active in the relevant securities and transactions and their counterparties, as the main parties the proposed amendments impact. FINRA does not expect the proposed rule amendments to diminish investor protections.

Anticipated Benefits

FINRA believes that a significant benefit of the proposed amendments to member firms is the increased clarity that they provide, coupled with exceptions and adjustments that will mitigate burden and promote compliance with the rule. FINRA is proposing to clarify that contracts that allow the payment of funds or delivery of securities by the customer beyond the T+2 window are classified as “extended settlement transactions” and thus must be margined accordingly, subject to specific exceptions. FINRA believes that this clarity should result in consistent treatment of such transactions, reduce regulatory costs and potentially level the playing field for member firms when competing in such markets. Moreover, the proposed amendments aim to clarify that extended settlement transactions (and other extensions of credit, such as reverse repos and non-purpose borrowing agreements) with broker-dealers (other than exempted borrowers) are subject to Rule 4210. Further, the proposal could benefit member firms by reducing the resources spent on resolving issues regarding contracts for delayed payment or delivery. This could lead to an enhanced balance of compliance, resources and risk taking.

The proposed amendments to the rule regarding when issued securities also provide member firms with the ability to take a capital charge in lieu of margin in all exempt accounts and bona fide DVP customers. This would address one of the issues identified through FINRA’s examination program regarding the fact that member firms are, as a practical matter, unable to collect margin from DVP customers. Member firm customers could potentially benefit from this flexibility, as their funds for potential margin requirements would be available for other uses. Moreover, the proposed provisions with respect to taking a capital charge in lieu of collecting margin are aligned with those proposed in proposed Rule 4210(e)(2)(H), providing operational and compliance alignment and consistency. The proposed amendments for bona fide DVP customers and the new exceptions for U.S. Treasury and municipal securities are expected to provide benefits similar to those discussed above.

The proposed amendments are not expected to diminish investor protections. The amendments could result in a change to the number of transactions for which margin is collected, or for which firms take a capital charge in lieu of margin, compared to current practices. Moreover, the proposed clarifications could help to level the playing field for member firms, fostering competition and potentially leading to more choice to the investor community.

Anticipated Costs

FINRA believes that the proposed rule amendments would result in some direct costs to member firms and their customers. One such potential direct cost could stem from possible increased capital charges for member firms that have not been treating extended settlement transactions as extensions of credit. A second potential direct cost could stem from the proposal to allow firms to take a capital charge in lieu of collecting margin. Taking a capital charge, in accordance with the proposal, is potentially less costly and will be done at the firm's discretion. However, doing so will reduce the amount of excess net capital a firm has available for other uses. Third, additional related costs could stem from complying with the permitted limits on taking such capital charges as well as from the compliance systems needed to ensure that the limits on taking such capital charges are met.

For the limited category of extended settlement transactions permitted in the cash accounts of bona fide DVP customers, member firms will need to begin collecting margin, or taking capital charges for uncollected margin, on these transactions. This requirement could result in member firms incurring some operational costs in establishing and maintaining new or additional margin accounts, as well as potential additional compliance costs. Similarly, for when issued transactions for the DVP accounts, member firms that have not been collecting margin or taking capital charges will be required to begin taking capital charges when no other exception applies.

Finally, customers who are counterparties to these transactions could incur some costs. First, those who do not already have accounts into which margin could be deposited could potentially incur costs associated with establishing such accounts. Second, customers will incur costs when required to supply margin under the proposed amendments.

Alternatives Considered

No alternatives were considered for the proposed amendments to Rule 4210.

Request for Comment

FINRA requests comment on all aspects of the proposal. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible. FINRA specifically requests comment concerning the following issues:

1. What are alternative approaches to address the stated concerns that FINRA should consider? How do those alternatives protect member firms against the credit risk inherent in the transactions?
2. Are there other ways in which FINRA applies Rule 4210 to extended settlement transactions, including impacts to the member firm operations and processes it uses, that should be modified? If so, how?
3. Should Rule 4210 also expressly address extended settlement transactions by broker-dealers for customers in non-securities?[19]
4. Under the proposed rule amendments the exception for when issued transactions with or for exempt accounts also applies to when issued transactions with or for non-member broker-dealers, which includes foreign broker-dealers, even if they do not qualify as exempt accounts. Is this treatment appropriate? If not, why not?
5. Regulation T requires broker-dealers to obtain full cash payment for a customer's cash account purchase of a foreign security within one payment period of the trade date or within one day after the date on which settlement is required to occur by the rules of the foreign securities market, provided this period does not exceed 35 calendar days. Is an additional exception required for foreign securities corresponding to the Regulation T provision (in addition to exceptions for U.S. Treasury securities and municipal securities)? If so, why are the exceptions included in the proposal not sufficient in the case of foreign securities?
6. Are there any material economic impacts, including costs and benefits to investors and firms, particularly smaller firms, that are associated specifically with the proposal? If so:
   - **a.** What are these economic impacts and what are their primary sources?
   - **b.** To what extent would these economic impacts differ by business attributes, such as size of the firm or differences in business models?
   - **c.** What would be the magnitude of these impacts, including costs and benefits?
7. Are there any expected economic impacts associated with the proposal not discussed in this *Notice*? What are they and what are the estimates of those impacts?
8. Are there any expected potential competitive effects associated with the proposal, whether across member firms or between member firms and non-member firms?

Endnotes

1. Parties should submit in their comments only personally identifiable information, such as phone numbers and addresses, that they wish to make available publicly. FINRA, however, reserves the right to redact or edit personally identifiable information from comment submissions. FINRA also reserves the right to redact, remove or decline to post comments that are inappropriate for publication, such as vulgar, abusive or potentially fraudulent comment letters.

2. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the Federal Register. Certain limited types of proposed rule changes take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.

3. As the Federal Reserve Board stated in 1940:

   The customer should have the necessary means of payment readily available when he purchases a security in the special cash account. He should expect to pay for it immediately or in any event within the period (of not more than a very few days) that is as long as is usually required to carry through the ordinary securities transaction.

   1940 Fed. Res. Bull. 1172, Federal Reserve Regulatory Service (FRRS) ¶ 5-501.

4. Although purchases and sales of exempted securities can only be booked into a cash account if the broker-dealer accepts in good faith a customer's agreement to promptly make full cash payment for a purchase (and owns and will promptly deposit a security sold), Regulation T does not require a broker-dealer to cancel or liquidate for nonpayment a customer's purchase of an exempted security. However, the Federal Reserve Board has stated that if exempted securities transactions are in a cash account, they "must be handled as any other bona fide cash transaction would be." *See* FRB Staff Opinion reported at FRRS ¶ 5-628.1.

5. Because it is unusual for a customer to agree to make full cash payment prior to the settlement date of the transaction, the member firm would be expected to document the customer's agreement to pay on T+2 **in order not to treat** such a transaction as an extended settlement transaction. If Rule 4210 is amended to incorporate the proposed new definition of "extended settlement transaction, FINRA staff intends to add the following interpretation of that definition to its Interpretations of FINRA's Margin Rule:

   /01 Customer Agreement to Pay or Deliver Prior to Settlement Date of Non-Regular Way Transaction

   If the member documents and accepts in good faith the customer's agreement to make payment or delivery by T+2, the transaction is not an "extended settlement transaction" as defined in Rule 4210(a)(18), even if:

   i. A later date is specified as the transaction's "settlement date" in the transaction confirmation, a customer statement or the member's books and records; or

   ii. The member is not obligated to deliver securities (in the case of a customer purchase) or make payment to the customer (in the case of a customer sale) until a later date.

   If a customer has agreed to make payment for securities purchased or deliver securities sold prior to the settlement date of the transaction communicated to the customer in a transaction

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confirmation or otherwise, the member cannot accept such agreement in good faith unless the member has reason to believe that the customer understands that the settlement date communicated to the customer is not the date on which the customer is obligated to make payment for the purchase of securities or deliver the securities sold.

6 For purposes of this *Notice*, references to paragraph (e)(2)(H) are to the rule as approved by the SEC pursuant to SR-FINRA-2015-036 (establishing margin requirements for Covered Agency Transactions). *See also* note 16 below.

7 T+3 transactions in agency CMOs are not Covered Agency Transactions because Clause 3 of the definition of "Covered Agency Transaction" in Rule 4210(e)(2)(H)(i)c. covers:

3. Transactions in Collateralized Mortgage Obligations ("CMOs"), as defined in Rule 6710(dd), issued in conformity with a program of an Agency, as defined in Rule 6710(k), or a Government-Sponsored Enterprise, as defined in Rule 6710(n), **for which the difference between the trade date and contractual settlement date is greater than three business days.** (emphasis added)

Proposed Rule 4210(f)(3)(D) provides that:

Paragraph (f)(3) of this Rule shall not apply to any Covered Agency Transaction or to any transaction in Collateralized Mortgage Obligations ("CMOs"), as defined in Rule 6710(dd), issued in conformity with a program of an Agency, as defined in Rule 6710(k), or a Government-Sponsored Enterprise, as defined in Rule 6710(n), for which the difference between the trade date and contractual settlement date is three business days.

8 An ordinary DVP transaction is not considered an extended settlement transaction. In an ordinary DVP transaction, the seller agrees to deliver on T+2 (or otherwise within the ordinary T+2 settlement cycle, *i.e.,* promptly) and the buyer agrees to make payment against delivery. Similar to first bulleted example above, even if there are unforeseen mechanics of the transaction that in fact cause a delay in delivery (and therefore a delay in the payment against that delivery), such DVP transaction is still not an extended settlement transaction.

In some unusual DVP transactions, however, the parties agree or expect that, due to the mechanics of the transaction, delivery (and therefore payment against that delivery) will not occur within the ordinary settlement cycle. For example, a member firm could sell an asset-backed security to a bona fide DVP customer within a "blackout period" when settlements cannot occur by T+2 because the principal amount of the security is unknown. In such a case, the member firm and the customer know at the time of the transaction that the mechanics of the transaction (the "blackout period") will delay the member firm's delivery—and therefore the bona fide DVP customer's payment—until after T+2. C.f. FRB Staff Opinion reported at FRRS ¶ 5-615.956.

These unusual DVP transactions are extended settlement transactions since the agreement with the customer does not provide for the customer to make payment (or delivery) within the ordinary T+2 settlement cycle. Such transactions are eligible for the exception if the customer is a bona fide DVP customer, the agreed or expected delay is not more than 35 calendar days, and the member firm takes a capital charge for otherwise required margin.

9 Rule 11860, among other things, requires the customer's agreement to furnish its agent with instructions regarding the receipt or delivery of securities involved in POD/COD transactions promptly. It also requires the use of the facilities of a Clearing Agency or a Qualified Vendor for the electronic confirmation and affirmation of depository eligible transactions. To qualify any non-depository eligible transactions for the exception, the definition of "bona fide DVP customer" adds a requirement that, to the extent applicable, the POD/COD arrangement must also provide for the prompt affirmation of any non-depository transactions.

10 These are transactions in securities for settlement when, as and if they are issued, and for purposes of Rule 4210 also include transactions in securities for settlement when, as and if they are distributed (when distributed).

11 If this exception to Rule 4210 is revised as proposed, FINRA staff intends to illustrate its limitations by adding the following to its Interpretations of FINRA's Margin Rule:

/02 Equity Security which Is the Subject of a Primary Distribution in Connection with a Bona Fide Initial Public Offering by the Issuer to the General Public for "Cash"

The following are ineligible for the exception in Rule 4210(f)(3)(B)(i):

- non-equity securities;
- equity securities issued in secondary or follow-on offerings;
- equity securities issued in exchange offerings;
- securities issued in Rule 144A offerings, Regulation D offerings and other private placements.

12 The 42-calendar-day period aligns with a longstanding interpretation of the SEC's net capital rule, which allows 42 calendar days after the trade date before a capital charge would be required for a cash account deficit arising from a COD transaction in municipal securities. See Interpretation /02 to SEA Rule 15c3-1(c)(2)(iv)(B) in FINRA's Interpretations of Net Capital Requirements for Brokers or Dealers.

13 "Designated account" is defined in Rule 4210(a)(4) as the account of:

(A) a bank (as defined in Section 3(a)(6) of the Exchange Act),

(B) a savings association (as defined in Section 3(b) of the Federal Deposit Insurance Act), the deposits of which are insured by the Federal Deposit Insurance Corporation,

(C) an insurance company (as defined in Section 2(a)(17) of the Investment Company Act),

(D) an investment company registered with the SEC under the Investment Company Act,

(E) a state or political subdivision thereof, or

(F) a pension or profit sharing plan subject to the Employee Retirement Income Security Act (ERISA) or of an agency of the United States or of a state or a political subdivision thereof.

14 "Exempt account" is defined in Rule 4210(a)(13) generally to include any member, non-member broker-dealer registered as a broker or dealer under the Exchange Act, or designated account, as well as any person that has a net worth of at least $45 million, financial assets of at least $40 million and makes available through public filings or

otherwise information regarding ownership, business, operations and financial condition sufficient for the firm to perform a risk analysis in respect of the person.

15. FINRA amended paragraph (e)(2)(I) in connection with the margin requirements for Covered Agency Transactions that the SEC approved pursuant to SR-FINRA-2015-036. *See* Securities Exchange Act Release No. 78081 (June 15, 2016), 81 FR 40364 (June 21, 2016) (Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval to a Proposed Rule Change to Amend FINRA Rule 4210 (Margin Requirements) to Establish Margin Requirements for the TBA Market, as Modified by Amendment Nos. 1, 2, and 3; File No. SR-FINRA-2015-036) and *Regulatory Notice 16-31*. FINRA has extended, to October 26, 2021, the implementation date of the Covered Agency Transaction margin requirements, including the amendments to paragraph (e)(2)(I). *See* Securities Exchange Act Release No. 90852, 86 FR 2021 (January 11, 2021) (Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Extend the Implementation Date of Certain Amendments to FINRA Rule 4210 Approved Pursuant to SR–FINRA–2015–036; File No. SR-FINRA-2020-046). In extending the implementation date, FINRA noted that it is considering amendments to the requirements adopted pursuant to SR-FINRA-2015-036. FINRA notes that the amendments to paragraph (e)(2)(I) proposed in this *Notice* will be coordinated with any amendments to paragraph (e)(2)(I) that may be proposed in connection with the Covered Agency Transaction requirements.

16. *See* Securities Exchange Act Release No. 42858 (May 30, 2000) 65 FR 36194, 36194 (June 7, 2000) (Order Approving NASD-99-05) (clarifying that "transactions in good faith accounts raise the same safety and soundness questions as transaction in cash and margin accounts.") NASD, the predecessor to FINRA, amended NASD Rule 2520(c), which became FINRA Rule 4210(c), "to require all accounts, including good faith accounts, to maintain margin required by NASD Rule 2520."

17. *See https://www.finra.org/rules-guidance/rulebooks/finra-rules/4210*.

18. Extended settlement transactions in agency MBS were excluded from this analysis because covered agency transactions are excluded from the proposed amendments.

19. For example, should Rule 4210 expressly address extended settlement transactions in certificates of deposit that are not securities? If a member sells such a CD to a customer for settlement beyond T+2, that is an extension of nonpurpose credit to that customer against the CD. As explained in interpretation /03 to Rule 4210(e)(7), an extension of credit against a certificate of deposit can be made without any other collateral, provided that the member takes capital charges as described in interpretation /10 to SEA Rule 15c3-1(c)(2)(iv)(B). Should this be stated expressly in the rule?

Attachment A

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

* * * * *

4210. Margin Requirements

(a) Definitions

For purposes of this Rule, the following terms shall have the meanings specified below:

(1) and (2) No Change.

(3) The term "customer" means any person for whom securities are purchased or sold or to whom securities are purchased or sold whether on a regular way, when issued, delayed or future delivery basis. It will also include any person for whom securities are held or carried and to or for whom a member extends, arranges or maintains any credit. The term will not include the following: (A) a broker or dealer from whom a security has been purchased or to whom a security has been sold on a regular way basis for the account of the member or its customers, or (B) an "exempted borrower" as defined by Regulation T of the Board of Governors of the Federal Reserve System ("Regulation T"), except for the proprietary account of a broker-dealer carried by a member pursuant to paragraph (e)(6) of this Rule. The term "customer" includes another broker or dealer (other than an exempted borrower) whenever the member extends, arranges or maintains any credit on behalf of the other broker or dealer, including by entering or maintaining an extended settlement transaction, reverse repurchase transaction, or non-purpose securities borrow transaction with the other broker-dealer.

(4) through (12) No Change.

(13) The term "exempt account" means:

(A) No Change.

(B) any person that:

(i) has a net worth of at least $45 million and financial assets of at least $40 million [for purposes of paragraphs (e)(2)(F) and (e)(2)(G)], and

(ii) No Change.

(14) through (16) No Change.

(17) The term "bona fide DVP customer" means a customer with whom the member has a payment on delivery (POD)/collect on delivery (COD) arrangement that satisfies the requirements of FINRA Rule 11860, and, to the extent applicable, provides for prompt affirmation of any non-depository eligible transactions.

(18) The term "extended settlement transaction" means any contract for the purchase or sale of a security (including any exempted security) that does not provide for the payment of funds by the customer (in the case of a customer purchase) or delivery of securities by the customer (in the case of a customer sale) by the second business day after the date of the contract.

(b) through (d) No Change.

(e) Exceptions to Rule

(1) No Change.

(2) Exempted Securities, Non-equity Securities and Baskets

(A) through (H) No Change.

(I) Limits on Net Capital Deductions

(i) Members shall maintain a written risk analysis methodology for assessing the amount of credit extended to exempt accounts pursuant to paragraphs (e)(2)(F) and (e)(2)(G) which shall be made available to FINRA upon request.

(ii) In the event that the net capital deductions taken by a member as a result of uncollected margin incurred under paragraph (f)(3) and as a result of marked to the market losses incurred under paragraphs (e)(2)(F) and (e)(2)(G) (exclusive of the percentage requirements established thereunder) exceed:

a. on any one account or group of commonly controlled accounts, 5 percent of the member's tentative net capital (as such term is defined in SEA Rule 15c3-1), or

b. on all accounts combined, 25 percent of the member's tentative net capital (as such term is defined in SEA Rule 15c3-1),

and, such excess exists on the fifth business day after it was incurred, the member shall give prompt written notice to FINRA and shall not enter into any new transaction(s) subject to the provisions

of paragraph (e)(2)(F), [or] (e)(2)(G) or (f)(3) that would result in an increase in the amount of such excess under, as applicable, subparagraph (ii).

(3) through (5) No Change

(6) Broker-Dealer Accounts

(A) A member may carry the proprietary account of another broker-dealer, which is registered with the SEC, or otherwise extend credit to such a broker-dealer, upon a margin basis which is satisfactory to both parties, provided the requirements of Regulation T and Rules 400 through 406 of SEC Customer Margin Requirements for Security Futures and Rules 41.42 through 41.49 under the CEA are adhered to and the account is not carried in a deficit equity condition. The amount of any deficiency between the equity maintained in the account and the haircut requirements pursuant to SEA Rule 15c3-1 and, if applicable, Rule 4110(a), shall be charged against the member's net capital when computing net capital under SEA Rule 15c3-1 and Rule 4110(a). However, when computing charges against net capital for transactions in securities covered by paragraphs (e)(2)(F) and (e)(2)(G) of this Rule, absent a greater haircut requirement that may have been imposed on such securities pursuant to Rule 4110(a), the respective requirements of those paragraphs may be used, rather than the haircut requirements of SEA Rule 15c3-1.

(B) No Change.

(7) and (8) No Change.

(f) Other Provisions

(1) and (2) No Change.

(3) [“]When Issued[”] and [“]When Distributed[”] [Securities] Transactions and Other Extended Settlement Transactions

(A) [Margin Accounts] General Rule for When Issued and When Distributed Transactions

(i) Except as provided in subparagraph (B):

a. The margin to be maintained on any transaction or net position in each [“]when issued[”] security shall be the same as if such security were issued[.];

b. Each position in a [“]when issued[”] security shall be margined separately and any unrealized profit shall be of value only in providing the amount of margin required on that particular position[.];

c. When an account has a “short” position in a [“]when issued[”] security and there are held in the account securities upon which the [“]when issued[”] security may be issued, such “short” position shall be marked to the market and the balance in the account shall for the purpose of this Rule be adjusted for any unrealized loss in such “short” position[.]: and

d. On any extended settlement transaction or net position resulting from extended settlement transactions in a when issued security in a cash account, equity must be maintained equal to the margin required were such transaction or position in a margin account.

(ii) The term “when issued” as used herein also means “when distributed.”

(B) [Cash Accounts] Exceptions to General Rule for When Issued and When Distributed Transactions

[On any transaction or net position resulting from contracts for a “when issued” security in an cash account other than that of a member, non-member broker-dealer, or a “designated account,” equity must be maintained equal to the margin required were such transaction or position in a margin account.]

[On any net position resulting from contracts for a “when issued” security made for with a non-member broker-dealer, no margin need be required, but such net position must be marked to the market.]

(i) On any transaction or net position resulting from contracts for a [“] when issued[”] security in a cash account made with or for [a member or a “designated account,”] an exempt account or a non-member broker-dealer, no margin need be required and such transaction or net position need not be marked to the market. However, where such transaction or net position is not marked to the market, an amount equal to the loss at the market in such position shall be charged against the member’s net capital as provided in SEA Rule 15c3-1 and, if applicable, FINRA Rule 4110(a), subject to the limits provided in paragraph (e)(2)(I) of this Rule.

(ii) No margin need be required, and no capital charge need be taken for mark to market losses on [The provisions of this paragraph (f)(3) shall not apply to] any position resulting from contracts on a ["]when issued["] basis in a cash account in [a security]:

[(i)]a. any equity security which is the subject of a primary distribution in connection with a bona fide initial public offering by the issuer to the general public for ["]cash["]; [or]

b. any U.S. Treasury security with a scheduled issuance date no later than the 14th calendar day after the date of the contract;

c. any municipal security with a scheduled issuance date no later than the 42nd calendar day after the date of the contract; and

[(ii)]d. any security which is exempt by FINRA as involving a primary distribution.

(iii) A member may elect not to collect margin from a bona fide DVP customer on any transaction or net position resulting from contracts for a when issued security in such customer's cash account, provided that settlement of the transaction occurs promptly after the securities are made available for delivery, and no later than the 35th calendar day after the trade date, and the member deducts the amount of any otherwise required margin from such member's net capital computed as provided in SEA Rule 15c3-1 and, if applicable, FINRA Rule 4110(a), subject to the limits provided in paragraph (e)(2)(I) of this Rule.

[The term "when issued" as used herein also means "when distributed."]

(C) Other Extended Settlement Transactions

On any extended settlement transaction or net position resulting from an extended settlement transactions in a cash account, equity must be maintained equal to the margin required were such transaction or position in a margin account, except for:

(i) any transaction or net position resulting from contracts in a when issued security subject to paragraph (f)(3)(B);

(ii) the purchase of a new refunding security, provided that such purchase is made no more than more than 35 calendar days prior to the date of maturity or redemption of an old security of the same issuer that is held in the customer's cash account, and is for an amount that does not exceed 103% of the proceeds of such old security; and

(iii) any extended settlement transaction in the cash account of a bona fide DVP customer if delivery of the security is delayed not more than 35 calendar days after the trade date due to the mechanics of the transaction, and not the customer's willingness or ability to pay, provided that the member deducts the amount of any otherwise required margin from such member's net capital computed as provided in SEA Rule 15c3-1 and, if applicable, FINRA Rule 4110(a), subject to the limits provided in paragraph (e)(2)(I) of this Rule.

(D) Covered Agency Transactions Not Subject to Paragraph (f)(3)

Paragraph (f)(3) of this Rule shall not apply to any Covered Agency Transaction or to any transaction in Collateralized Mortgage Obligations ("CMOs"), as defined in Rule 6710(dd), issued in conformity with a program of an Agency, as defined in Rule 6710(k), or a Government-Sponsored Enterprise, as defined in Rule 6710(n), for which the difference between the trade date and contractual settlement date is three business days.

(4) through (10) No Change.

(g) and (h) No Change.

• • • Supplementary Material: --------------

.01 through .05 No Change.

.06 Good Faith Account. A Regulation T good faith account, other than a non-securities account, is treated as a margin account for purposes of Rule 4210.

* * * * *

Attachment B

Illustrations of the Application of the Proposed Amendments as if adopted

For purposes of these illustrations:

The "Exempt Account Exception" refers to the exception pursuant to Rule 4210(f)(3)(B)(i), which applies to when-issued transactions in a cash account of a non-member broker-dealer or an exempt account; and

The "DVP Account Exception" refers to the exception pursuant to Rule 4210(f)(3)(B)(iii), which applies to when-issued transactions in the cash account of a bona fide DVP customer and settlement of the transaction occurs promptly after the securities are made available for delivery and no later than the 35th calendar day after the trade date.

Part I – When Issued Transactions.

A. **Equity IPO.** On T, a customer purchases common shares in an initial public offering (IPO) for settlement when, as, and if the shares are issued. The shares are to be issued on T+7.

If the customer's purchase is effected in a cash account (including a DVP account), then pursuant to Rule 4210(f)(3)(B)(ii)a. no margin need be required, and no capital charge need be taken for mark to market losses so long as the IPO is a bona fide initial public offering to the general public for cash.

If the customer's purchase is effected in a margin account, then, pursuant to Rule 4210(f)(3)(A)(i)a., the margin to be maintained on the customer's purchase is the same as if the shares were issued.

B. **Equity Follow-On Offering.** On T, a customer purchases common shares in a public offering for settlement when, as, and if the shares are issued. The shares are to be issued on T+7. This is a follow-on offering; the common shares were the subject of an IPO some time before the offering in which the customer purchased the shares.

The Rule 4210(f)(3)(B)(ii)a. exception is not available because the offering is not an initial public offering.

If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[1]

If the Exempt Account Exception is not available, but the DVP Account Exception is available, the firm may elect not to collect margin from the customer provided that the firm takes a capital charge for the amount of the otherwise required margin.[2]

If the customer's purchase is effected in a cash account and neither the Exempt Account Exception nor the DVP Account Exception is available, then, pursuant to Rule 4210(f)(3)(B)(i)d., the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account (or good faith account), then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the shares were issued.

C. **Equity Follow-On Offering – Capital Charge Illustration.** A firm is the underwriter in a registered follow-on offering of $10 million of exchange-listed equity common shares. The registration statement was effective after the close of business on T-1 and the shares are to be issued on T+7. On T, the firm confirmed the sale of $7 million of shares in cash accounts of exempt account customers (or non-member broker-dealers), $2 million of shares to non-exempt bona fide DVP customers (that are not broker-dealers), and $1 million of shares to regular (non-exempt, non-DVP customers that are not broker-dealers). The firm makes margin calls for all margin it is required to collect (and does not make margin calls for any margin it is not required to collect). The firm is subject to the following capital charges in connection with this distribution:

   a. **Open Contractual Commitment Charges:** Assuming that the firm's underwriting commitment was conditioned on the effectiveness of the registration statement, the firm was subject to an open contractual commitment charge under Rule 15c3-1(c)(2)(viii) when the registration statement became effective on T-1. For a follow-on offering of equity securities, the charge is 15% of the $10 million commitment, or $1.5 million, reduced by the firm's unrealized profit and any applicable amount of the $150,000 add-back. Once the firm confirmed sales of its entire commitment on T, the open contractual commitment charge was no longer required.

   b. **Customers Qualifying for the Exempt Account Exception.** The firm sold $7 million of shares in the cash accounts of exempt account customers or non-member broker-dealers. Under Rule 4210(f)(3)(B)(i), the firm is not required to collect margin from these customers and is only required to take a capital charge if and when the customers incur a mark to market loss. If the market value of the shares declines below the offering price, creating a mark to market loss (and no margin is called or collected from these customers[3]), the firm is required to take a capital charge for the amount of the mark to market loss on the day it occurs and each subsequent day until it is eliminated or the purchase is settled.[4]

c. **Non-Exempt Customers that qualify for the DVP Account Exception.** The firm sold $2 million of shares to bona fide DVP customers that were not exempt accounts (or non-member broker-dealers). Under Rule 4210(f)(3)(B)(iii), the firm is not required to collect margin from these customers, but is required to take a capital charge for the amount of otherwise required margin. If it were not for this exception, Rule 4210(f)(3)(A)(i)a. and d. would require the firm to collect the margin that would be required if the shares were issued and purchased in a margin account. Under Rule 4210(c)(1), the margin on listed shares to be maintained in margin accounts is 25% of their current market value, or $500,000. Since the firm did not make any margin calls on these customers,[5] this capital charge is required as of T and each subsequent day until the customers pay for the shares. If the market value of the shares declines below the offering price, creating a mark to market loss (and no margin is called or collected from these customers), the firm is also required to take a capital charge for the amount of the mark to market loss as of the day it occurs and each subsequent day until it is eliminated or the purchase is settled.[6]

d. **All Other Customers.** The firm sold $1 million of shares to customers that were not exempt accounts, non-member broker-dealers, or bona fide DVP customers. Whether the sales were effected in the customers' cash or margin accounts, the firm is required by Rule 4210(f)(3)(A)(i)a. and d. to collect the margin that would be required if the shares were issued and purchased in a margin account. Under Rule 4210(c)(1), the margin on listed shares to be maintained in margin accounts is 25% of their current market value, or $250,000 in aggregate. The firm is required to take a capital charge for any margin deficit, but it is permitted to give credit for margin calls outstanding five business days or less. Because it made margin calls for all required margin,[7] the firm will not incur any capital charges with respect to these accounts until T+5 at the earliest, and then only to the extent there are unmet margin calls.

D. **Equity Rights Offering.** On T, a customer exercises rights to purchase preferred shares in a registered rights offering. The preferred shares to be issued on T+7. No preferred shares of this class had been sold prior to the sales under the rights that were distributed to the holders of the issuer's common shares.

Although the preferred shares are equity securities and the sale under the rights offering is their initial public sale, the exception pursuant to Rule 4210(f)(3)(B)(ii)a. is not available because the shares are not being sold to the general public, but only to the rights holders (and the rights were distributed only to the holders of issuer's common shares).

If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[8]

If the Exempt Account Exception is not available but the DVP Account Exception is available, the firm may elect not to collect margin from the customer provided that the firm takes a capital charge for the amount of the otherwise required margin.[9]

If the customer's purchase is effected in a cash account and neither the Exempt Account Exception nor the DVP Account Exception is available, then, pursuant to Rule 4210(f)(3)(A)(i)d., the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account, then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the shares were issued.

E. **Equity Exchange Offering.** On T, a customer elects to participate in an exchange offer to exchange a corporate issuer's bonds for preferred shares in the issuer. The preferred shares are to be issued on T+7. No preferred shares of that class had been sold prior to the exchange offering.

Although the preferred shares are equity securities and the sale in the exchange offering is their initial public sale, the exception pursuant to Rule 4210(f)(3)(B)(ii) a. is not available because the shares are not being sold to the general public and they are not sold for cash.

If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[10]

If the Exempt Account Exception is not available but the DVP Account Exception is available, the firm may elect not to collect margin from the customer provided that the firm takes a capital charge for the amount of the otherwise required margin.[11]

If the customer's purchase is effected in a cash account and neither the Exempt Account Exception nor the DVP Account Exception is available, then, pursuant to Rule 4210(f)(3)(A)(i)d, the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account, then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the shares were issued.

F. **Debt IPO.** On T, the firm sells a corporate bond to a customer in a public offering, for settlement when, as, and if the bonds are issued. The bonds are to be issued on T+7.

The exception pursuant to Rule 4210(f)(3)B)(ii)a. is not available because the bond is not an equity security.

If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[12]

If the Exempt Account Exception is not available but the DVP Account Exception is available, the firm may elect not to collect margin from the customer provided that the firm takes a capital charge for the amount of the otherwise required margin.[13]

If the customer's purchase is effected in a cash account and neither the Exempt Account Exception nor the DVP Account Exception is available, then, pursuant to Rule 4210(f)(3)(A)(i)d., the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account (or good faith account[14]), then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the bond were issued.

G. **U.S. Treasury Securities, Scheduled Issuance within 14 Calendar Days of Trade Date.** On T, a customer purchases U.S. Treasury securities for settlement, when, as, and if issued. The scheduled issuance date ("dated date") is T+7.

If the customer's purchase is effected in a cash account (including a DVP account), then pursuant to Rule 4210(f)(3)(B)(ii)b. no margin need be required, and no capital charge need be taken for mark to market losses because the scheduled issuance date of T+7 is not later than the 14th calendar day after T.[15]

If the customer's purchase is effected in a margin account (or good faith account), then, pursuant to Rule 4210(f)(3)(A)(i)a., the margin to be maintained on the customer's purchase is the same as if the U.S. Treasury securities were issued.

H. **U.S. Treasury Securities, Scheduled Issuance Not within 14 Calendar Days of Trade Date.** On T, a customer purchases U.S. Treasury securities for settlement, when, as, and if issued. The scheduled issuance date ("dated date") is T+18.

The exception pursuant to Rule 4210(f)(3)(B)(ii)b. is not available because the scheduled issuance date of T+18 is later than the 14th calendar day after T.

If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[16]

If the Exempt Account Exception is not available but the DVP Account Exception is available, the firm may elect not to collect margin from the customer provided that the firm takes a capital charge for the amount of the otherwise required margin.[17]

If the customer's purchase is effected in a cash account and neither the Exempt Account Exception nor the DVP Account Exception is available, then, pursuant to Rule 4210(f)(3)(A)(i)d., the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account (or good faith account), then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the U.S. Treasury securities were issued.

I. **Municipal Securities, Dated Date within 42 Calendar Days of Trade Date.**
On T, a customer purchases municipal bonds for settlement, when, as, and if issued. The scheduled issuance date ("dated date") is T+7.

Because the customer purchased municipal bonds, if the customer's purchase is effected in a cash account (including a DVP account), then pursuant to Rule 4210(f)(3)(B)(ii)c. no margin need be required, and no capital charge need be taken for mark to market losses because the scheduled issuance date of T+7 is not later than the 42nd calendar day after T.[18]

If the customer's purchase is effected in a margin account (or good faith account), then, pursuant to Rule 4210(f)(3)(A)(i)a., the margin to be maintained on the customer's purchase is the same as if the bonds were issued.

J. **Municipal Securities, Dated Date Not within 42 Calendar Days of Trade Date.**
On T, a customer purchases municipal bonds for settlement, when, as, and if issued. The scheduled issuance date ("dated date") is T+50.

The exception pursuant to Rule 4210(f)(3)(B)(ii)c. is not available because the scheduled issuance date of T+50 is later than the 42nd calendar day after T.

The DVP Account Exception is not available because the scheduled issuance date of the bonds is more than 35 calendar days after the trade date.

If the Exempt Account Exception is available, no margin need be required and the transaction need not be marked to the market, but the firm must take a capital charge for any unmargined mark to market loss.[19]

If the customer's purchase is effected in a cash account and the Exempt Account Exception is not available, then, pursuant to Rule 4210(f)(3)(A)(i)d., the margin to be maintained on the customer's purchase is the same as if the transaction were effected in a margin account.

If the customer's purchase is effected in a margin account (or good faith account),[20] then pursuant to Rule 4210(f)(3)(A)(i)a. the margin to be maintained on the customer's purchase is the same as if the bond were issued.

Part II — Other Extended Settlement Transactions

K. **U.S. Treasury Securities Sold for T+4 Payment.** On T, a firm sells an issued U.S. Treasury security in a transaction where the buyer is not required to pay until T+4. This is an extended settlement transaction.

L. **Cash Account Purchase with T+4 Settlement Date.** On T, a firm sells a security to a customer in a transaction with a stated settlement date of T+4. This transaction is generally an extended settlement transaction; however, it would not be an extended settlement transaction if the firm documents and accepts in good faith the purchaser's agreement to deposit full cash payment for the security with the firm by T+2.

M. **Regular Way Sale to DVP Account.** On T, the firm sells a security to a bona fide DVP customer. Under the firm's agreement with the DVP customer, the customer is required to pay when the firm delivers the security. At the time of the transaction, the firm expected that the transaction would be settled on T+2 in the ordinary course of business. Unexpected delays due to the mechanics of the transaction, however, cause a delay in delivery until T+7, at which time the customer makes full cash payment.

   This transaction is not an extended settlement transaction. The customer agreed to make full cash payment upon an occurrence of an event (the delivery of the security) that the firm expects would occur on T+2 in the ordinary course of business.

   This transaction should have a stated settlement of T+2 since that is the date the firm expects to settle.

N. **Sale to DVP Account with Expected Delays.** On T, the firm sells a security to a bona fide DVP customer. Under the firm's agreement with the DVP customer, the customer is required to pay when the firm delivers the security. At the time of the transaction, the firm does not expect the security to be available for delivery until after T+2.

   This is an extended settlement transaction because the customer has not agreed to pay by T+2, but rather upon the occurrence of an event that the firm does not expect to occur until after T+2.[21] However, if the expected delay is due to the mechanics of the transaction (not the customer's willingness or ability to pay) and does not extend beyond 35 calendar days from the trade date, then pursuant to Rule 4210(f)(3)(C)(iii), the firm may take a capital charge in lieu of collecting margin from the bona fide DVP customer.[22]

O. **Extended Settlement Transaction with Broker-Dealer.** On T, the firm sells an issued security to another registered broker-dealer in a transaction where the buyer is not required to pay until T+6. This is an extended settlement transaction subject to Rule 4210, unless the other broker-dealer is an exempted borrower under Regulation T. If the other broker-dealer is not an exempted borrower, then pursuant to Rule 4210(e)(6)(A), the transaction may be maintained on a margin basis satisfactory to the firm and the other broker-dealer, provided that the firm adheres to Regulation T, does not carry the other broker-dealer's account in a deficit equity condition, and takes the capital charges required by Rule 4210(e)(6)(A).

P. **Customer Purchase with Expected Delays.** On T, the firm sells a security to a customer that the firm does not expect to have available for delivery until T+7. The firm agrees with the customer that payment will be due upon delivery, but the firm and the customer do not have a payment on delivery (POD)/collect on delivery (COD) arrangement that satisfies the requirements of FINRA Rule 11860.

   This is an extended settlement transaction. Although the delays in settlement are due to the mechanics of the transaction, the firm cannot avail itself of Rule 4210(f)(3)(C)(iii) to take a capital charge in lieu of collecting margin because the customer is not a bona fide DVP customer.

Q. **Long Sale with Expected Delays.** On T, a customer sells in the customer's cash account a security that the customer owns (and has paid for in full), but does not expect to be able to deposit with the firm by T+2. This is an extended settlement transaction.

Endnotes

1. Capital charges in lieu of margin under Rule 4210(f)(3) are limited by the firm's capital. Pursuant to Rule 4210(e)(2)(I), if the aggregate amount of capital charges for uncollected mark to market loss under Rule 4210(e)(2)(F) and (G) and uncollected margin under Rule 4210(f)(3) exceed for five business days either 5% of the firm's tentative net capital with respect to a single account or group of commonly controlled accounts or 25% of the firm's tentative net capital across all accounts, the firm must give notice to FINRA and may not enter into new transactions subject to paragraphs (e)(2)(F), (e)(2)(G), or (f)(3) that would result in an increase in the excess above the 5% or 25% thresholds.
2. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.
3. To the extent the firm calls for margin from these customers, it may give credit in the computation of capital charges to margin calls outstanding five business days or less. For the margin calls to delay or reduce capital charges, they must be bona fide – the firm must have a margining arrangement with the customer and expect that the customer generally will promptly satisfy margin calls.
4. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.
5. This is an assumption in the example because firms generally do not collect margin from DVP customers.
6. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.
7. This is an assumption in the example. If the firm were to fail to make a bona fide margin call on any of these customers, capital charges would be incurred as of the day of the customer's purchase and each subsequent day the margin requirement remains unmet.
8. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.
9. Capital charges in lieu of margin are limited by the firm's capital. *See* 1 above.
10. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.
11. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.
12. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.
13. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.
14. Supplementary Material .06 makes clear that "A Regulation T good faith account is treated as a margin account for purposes of Rule 4210."
15. The availability of this exception depends on the length of the period between the trade date of the customer's purchase and the scheduled issuance date of the U.S. Treasury securities. If, for example, sales of the U.S. Treasury securities open on May 31 and the scheduled issuance date is June 15 (*i.e.,* 15 calendar days after May 31), then the exception does not apply to customers who purchase on May 31. The exception does apply, however, to customers who purchase the bonds on June 3, since June 15 is the 12th day after June 3.
16. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

17. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

18. The availability of this exception depends on the length of the period between the trade date of the customer's purchase and the scheduled issuance date of the municipal bonds. If, for example, sales of the municipal bonds open on May 31 and the scheduled issuance date is July 13 (*i.e.,* the 43rd calendar days after May 31), then the exception does not apply to customers who purchase on May 31. The exception does apply, however, to customers who purchase the bonds on June 3, since July 13 is the 40th calendar day after June 3.

19. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

20. Supplementary Material .06 makes clear that "A Regulation T good faith account is treated as a margin account for purposes of Rule 4210."

21. Although booking or confirming the transaction with a stated settlement date after T+2 is indicative of the firm's expectation that the transaction would not settle until after T+2, booking or confirming the transaction as T+2 would not prevent the transaction from being an extended settlement transaction when the firm does not expect settlement to occur on T+2.

22. Capital charges in lieu of margin are limited by the firm's capital. *See* note 1 above.

Attachment C