

Proposed new language is underlined; proposed deletions are in brackets.

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**Text of Proposed New FINRA Rule
(Marked to Show Changes from Incorporated NYSE Rules 296 and 402;
Incorporated NYSE Rules 296 and 402 to be Deleted in their Entirety from the
Transitional Rulebook)**

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4000. FINANCIAL AND OPERATIONAL RULES

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4300. OPERATIONS

4310. Member Agreements and Contracts

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[Rule 296]4314. [Liquidation of] Securities Loans and Borrowings

(a) Disclosure of Parties' Capacity in Loan or Borrow Transactions

(1) A member that lends or borrows securities in the capacity of agent shall disclose such capacity to the other party (or parties) to the transaction.

(2) Prior to lending securities to or borrowing securities from a person that is not a member of FINRA, a member shall determine whether the other party is acting as principal or agent in such transaction.

(3) A member that is a party to a security loan or borrow transaction, where the other party to such transaction is acting as agent, shall maintain books and records that reflect:

(A) the details of the transaction with the agent; and

(B) each principal(s) on whose behalf the agent is acting and the details of each transaction therewith.

([a]b) Right to Liquidate Transaction

Each member [or member organization] that is a party to an agreement with another member [or member organization] providing for the loan and borrowing of securities shall have the right to liquidate such transaction whenever the other party to such transaction:

(1) applies for or consents to, or is the subject of an application for, the appointment of or the taking of possession by a receiver, custodian, trustee, or liquidator of itself or of all or a substantial part of its property[.];

(2) admits in writing its inability, or becomes generally unable, to pay its debts as such debts become due[.];

(3) makes a general assignment for the benefit of its creditors[.]; or

(4) files, or has filed against it, a petition under Title 11 of the United States Code, or has filed against it an application for a protective decree under Section 5 of the Securities Investor Protection Act of 1970 (“SIPA”),

unless the[at] right to liquidate such transaction is stayed, avoided, or otherwise limited by an order authorized under the provisions of [the Securities Investor Protection Act of 1970] SIPA or any statute administered by the [Securities and Exchange Commission] SEC.

(b)(c) Written Agreement with Non-Members

No member [or member organization] shall lend or borrow any security to or from any person that is not a member of FINRA [non-member of the Exchange], except pursuant to a written agreement, which may consist of the exchange of contract confirmations, that confers upon such member [or member organization] the contractual right to liquidate such transaction because of a condition of the kind specified in paragraph (a)(b) [above] of this Rule.

••• **Supplementary Material:** -----

[.10].01 Definition of Agreement. [As used herein]For purposes of this Rule, an agreement for the loan and borrowing of securities shall mean a securities contract or other agreement, including related terms, for the transfer of securities against the transfer of funds, securities, or other collateral, with a simultaneous agreement by the transferee to transfer to the transferor against the transfer of funds, securities, or other collateral, upon notice, at a date certain, or upon demand, the same or substituted securities.

.02 Disclosure of Capacity. A member may satisfy its disclosure obligation in paragraph (a)(1) of this Rule by, among other things, providing specific disclosure of its capacity as agent in the written agreement between the parties or in the individual confirmations of each security exchanged between the parties for each loan and borrow transaction.

.03 Details of Transactions with Parties. For purposes of this Rule, a member shall create and maintain records for each security loan or borrow transaction in accordance with the requirements of SEA Rules 17a-3 and 17a-4. For purposes of paragraph (a)(3) of this Rule, when entering into a security loan or borrow transaction with a party that is

acting as agent on behalf of another principal(s), the member shall maintain a record of the details of each security loan or borrow with the agent, identifying the specific security and quantity loaned or borrowed, the contract value and the type and description of the collateral provided to the agent. In addition, the member's records shall reflect the quantity of securities loaned or borrowed from each principal on whose behalf the agent is acting and the amount and description of the collateral allocated to each such principal.

.04 Compliance with Rule 4330 When Borrowing Securities from a Customer.

When a member borrows securities from a customer, the member also is subject to Rule 4330(b)(2)(B)(ii), which requires members to provide disclosures to customers regarding the risks and financial impact associated with the customer's loan(s) of securities. Such written notice shall include a disclosure of the right of the member to liquidate the borrow transactions with the customer, as provided by paragraph (b) of this Rule.

[.20] **.05 Compliance with SEA Rule 15c3-3.** For purposes of paragraph (c) of this Rule, [E]each member [or member organization]subject to the provisions of SEA Rule 15c3-3 [under the Securities Exchange Act of 1934]that borrows securities from a customer (as defined in said rule) shall comply with the provisions thereof relating to the requirements for a written agreement between the borrowing member [or member organization]and the lending customer.

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[Rule 402]**4330. Customer Protection—[Reserves and Custody of Securities]**

Permissible Use of Customers' Securities

[(a) General Provisions]

[Each member organization shall obtain custody and control of securities and maintain reserves as prescribed by Rule 15c3-3 promulgated under the Securities Exchange Act of 1934. For the purpose of this Rule the definitions contained in such Rule 15c3-3 shall apply.]

(b)a) [Agreements for Use of] Authorization to Lend Customers' Margin Securities

No member [organization] shall lend[, either to itself as a broker-dealer or to others,] securities [which] that are held on margin for a customer and [which] that are eligible to be pledged or loaned, unless such member [organization] shall first have obtained a written authorization from such customer permitting the [loan] lending of such securities [by the member organization].

(b) Requirements for Borrowing of Customers' Fully Paid or Excess Margin Securities

(1) A member that borrows fully paid or excess margin securities carried for the account of any customer shall:

(A) comply with the requirements of SEA Rule 15c3-3;

(B) comply with the requirements of Section 15(e) of the

Exchange Act; and

(C) notify FINRA, in such manner and format as FINRA may require, at least 30 days prior to first engaging in such securities borrows.

(2) Prior to first entering into securities borrows with a customer pursuant to paragraph (b)(1) of this Rule, a member shall:

(A) have reasonable grounds for believing that the customer's loan(s) of securities are appropriate for the customer. In making this determination, the member shall exercise reasonable diligence to ascertain the essential facts relative to the customer, including, but not limited to, the customer's financial situation and needs, tax status, investment objectives, investment time horizon, liquidity needs, risk tolerance and any other information the customer may disclose to the member or associated person in connection with entering such securities loans.

(B) provide the customer, in writing (which may be electronic), with the following:

(i) clear and prominent notice stating that the provisions of the Securities Investor Protection Act of 1970 may not protect the customer with respect to the customer's securities loan transaction and that the collateral delivered to the customer may constitute the only source of satisfaction of the member's obligation in the event the member fails to return the securities; and

(ii) disclosures regarding the customer's rights with respect to the loaned securities, and the risks and financial impact associated with the customer's loan(s) of securities, including, but not limited to:

a. loss of voting rights;

b. the customer's right to sell the loaned securities and any limitations on the customer's ability to do so, if applicable;

c. the factors that determine the amount of compensation received by the member and its associated persons in connection with the use of the securities borrowed from the customer;

d. the factors that determine the amount of compensation (e.g., interest rate) to be paid to the customer and whether or not such compensation can be changed by the member under the terms of the borrow agreement;

e. the risks associated with each type of collateral provided to the customer;

f. that the securities may be "hard-to-borrow" because of short-selling or may be used to satisfy delivery requirements resulting from short sales;

g. potential tax implications, including payments deemed cash-in-lieu of dividend paid on securities while on loan; and

h. the member's right to liquidate the transaction because of a condition of the kind specified in Rule 4314(b).

(3) A member that is subject to paragraph (b)(1) of this Rule shall create and maintain records evidencing the member's compliance with the requirements of paragraph (b)(2) of this Rule. Such records shall be maintained in accordance with the requirements of SEA Rule 17a-4(a).

••• Supplementary Material:-----

.01 Definitions. For purposes of this Rule, the definitions contained in SEA Rule 15c3-3 shall apply.

.02 Authorization to Lend Customers' Margin Securities. For purposes of paragraph (a) of this Rule, members may use a single customer account agreement/margin agreement/loan consent signed by a customer as written authorization to permit the lending of a customer's margin eligible securities in lieu of obtaining a separate written authorization; provided such customer account agreement/margin agreement/loan consent includes clear and prominent disclosure that the firm may lend either to itself or others any securities held by the customer in its margin account.

.03 Notification to FINRA. FINRA, upon receipt of a member's written notification pursuant to paragraph (b)(1)(C) of this Rule, may request such additional information as it may deem necessary to evaluate compliance with SEA Rule 15c3-3, Section 15(e) of the Exchange Act and other applicable FINRA rules or federal securities laws or rules. Examples of additional information include, but are not limited to:

(a) the written agreement authorizing such borrowing of securities, which shall reflect the material terms of the arrangement;

(b) the types of customers that are parties to such securities borrows;

(c) the types of accounts used to effect the securities borrows (i.e., whether the subject securities are maintained in customers' cash or margin or other accounts);

(d) the types of collateral provided to customers in connection with such securities borrows, the frequency of marking to market of the collateral and the custody arrangements for such collateral;

(e) the operational and recordkeeping processes related to such securities borrows;

(f) the rebates paid/received in connection with such securities borrows and any other compensation arrangements related thereto;

(g) the procedures for handling customers' requests to sell the securities subject to such borrows; and

(h) disclosures made to customers.

.04 Appropriateness of Customer's Loan(s) of Securities. The member borrowing a customer's fully paid or excess margin securities is responsible for making the determination regarding the appropriateness of such borrow from a customer required by paragraph (b)(2)(A) of this Rule. However, in making that determination, when the member has entered into a carrying agreement with an introducing member, pursuant to Rule 4311, the member may rely on the representations of the introducing member that has a customer relationship with the lender.

.05 Appropriateness Determination for Institutional Customers. A member may fulfill the obligation set forth in paragraph (b)(2)(A) of this Rule for an institutional

account, as defined in Rule 4512(c), by complying with the requirements of Rule 2111(b).

.06 Notification to FINRA of Pre-existing Fully Paid or Excess Margin Securities

Borrows and Disclosures to Customers. Members with any existing fully paid or excess margin securities borrows with customers as of [insert effective date of the proposed rule change] shall notify FINRA in writing, in such manner and format as FINRA may require, of such borrows within 30 days from [insert effective date of the proposed rule change]. Further, such members shall provide such customers with the disclosures required by paragraph (b)(2)(B) of this Rule within 180 days of [insert effective date of the proposed rule change].

[.30 Securities Callable in Part]¹

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Text of Proposed New FINRA Rule

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4340. Callable Securities

(a) Allocation Procedures and Customer Notice

Each member that has in its possession or under its control any security which, by its terms, may be called or redeemed prior to maturity, shall:

(1) establish and make available on the member's website procedures by which it will allocate among its customers, on a fair and impartial basis, the securities to be redeemed or selected as called in the event of a partial redemption or call; and

¹ NYSE Rule 402.30 is being addressed separately as proposed new FINRA Rule 4340.

(2) provide written notice (which may be electronic) to new customers at the opening of an account, and all customers at least once every calendar year, of the manner in which they may access the allocation procedures on the member's website and that, upon a customer's request, the member will provide hard copies of the allocation procedures to the customer.

(b) Favorable Redemptions

Where redemption of callable securities is made on terms that are favorable to the called parties, a member shall not allocate the securities to any account in which it or its associated persons have an interest until all other customers' positions in such securities have been satisfied.

(c) Unfavorable Redemptions

Where the redemption of callable securities is made on terms that are unfavorable to the called parties, a member shall not exclude its positions or those of its associated persons (including those persons performing solely clerical and ministerial functions) from the pool of the securities eligible to be called.

••• Supplementary Material:-----

.01 Definition of Associated Person; Clerical and Ministerial Functions. The term "associated person" as used in this Rule shall have the meaning provided in Section 3(a)(18) of the Exchange Act, which expressly excludes, for certain purposes, any person associated with the member whose functions are solely clerical or ministerial (referred to as "clerical and ministerial associated persons"). With respect to a redemption made on terms that are favorable to the called parties, for purposes of paragraph (b) of this Rule, a member may include the accounts of clerical and ministerial associated persons in the

pool of the securities eligible to be called. With respect to a redemption made on terms that are unfavorable to the called parties, for purposes of paragraph (c) of this Rule, a member shall not exclude the accounts of clerical and ministerial associated persons from the pool of the securities eligible to be called.

.02 Allocations of Partial Redemptions or Calls. For purposes of paragraph (a)(1) of this Rule, a member's procedures may include the use of an impartial lottery system, acting on a pro-rata basis, or such other means as will achieve a fair and impartial allocation of the partially redeemed or called securities.

.03 Accounts of an Introducing Member and its Associated Persons. Where an introducing member is a party to a carrying agreement with another member that is conducting an allocation pursuant to paragraph (a) of this Rule, any accounts in which the introducing member or its associated persons have an interest shall be subject to paragraphs (b) and (c) of this Rule. The introducing member also shall identify such accounts to the member conducting the allocation.

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**Text of NASD Rules, Incorporated NYSE Rule and Incorporated
NYSE Rule Interpretations to be Deleted in their Entirety from the
Transitional Rulebook**

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NASD Rules

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[2330. Customers' Securities or Funds]

Entire text deleted.

[IM-2330. Segregation of Customers' Securities]

Entire text deleted.

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Incorporated NYSE Rule

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[402.30. Securities Callable in Part]

Entire text deleted.

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Incorporated NYSE Rule Interpretations

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[Rule 296. Liquidation of Securities Loans and Borrowings]

Entire text deleted.

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[Rule 402. Customer Protection — Reserves and Custody of Securities]

Entire text deleted.

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