

Minor Rule Violation Plan (MRVP) Amendment

SEC Announces Approval of Amendment to FINRA's MRVP to Include Violations of Options Position and Exercise Limits and Contrary Exercise Advice Procedures

Effective Date: June 6, 2008

Executive Summary

Effective June 6, 2008, FINRA's MRVP was expanded to include violations of options position and exercise limits and contrary exercise advice procedures.¹ The amended text of IM-9216, which describes FINRA's MRVP, is set forth in Attachment A of this *Notice*.

Questions concerning this *Notice* should be directed to Stan Macel, Assistant General Counsel, Office of General Counsel, at (202) 728-8056.

Background & Discussion

On June 6, 2008, the Securities and Exchange Commission (SEC) approved a rule change amending NASD Interpretive Material 9216 (IM-9216), which sets forth FINRA's MRVP. The MRVP allows FINRA to impose a fine of up to \$2,500 on any member firm or person associated with a member firm for a minor violation of the rules identified in IM-9216. The rule change amends IM-9216 to include the following violations in FINRA's MRVP:

- (1) options position and exercise limits under NASD Rule 2860(b)(3) and (b)(4), and
- (2) contrary exercise advice procedures under NASD Rule 2860(b)(23).

June 2008

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Options
- Registered Representatives
- Senior Management

Key Topic(s)

- MRVP
- Violations of Options Position and Exercise Limits
- Violations of Contrary Exercise Advice Procedures

Referenced Rules & Notices

- NASD IM-9216
- NASD Rule 2860

The purpose of the MRVP is to provide meaningful sanctions for minor or technical violations of rules when the initiation of a formal disciplinary proceeding would be more significant than warranted. Minor rule violation letters also represent a useful tool for implementing the concept of progressive discipline.

Inclusion of a rule in the MRVP does not mean that all violations of that rule should be treated as minor rule violations, and, in fact, significant violations would not be handled under the MRVP. Accordingly, under the MRVP, FINRA retains the discretion to bring full disciplinary proceedings for any violation of a rule included in the MRVP.

FINRA's options rule contains provisions imposing limits on the size of an options position, and limits on the number of options contracts that can be exercised into shares of the underlying security during a fixed period. To address inadvertent violations of these provisions, due to, among other things, miscounting, technical problems or a misinterpretation of the position limit calculation methodologies that in the judgment of FINRA do not materially affect the market, FINRA has included violations of options position and exercise limits as eligible for disposition under the MRVP. Violations of these provisions deemed to have a manipulative effect or intent would not be treated as minor rule violations.

Options issued by The Options Clearing Corporation (*i.e.*, exchange-traded options) have specific terms regarding whether options that can be settled only by delivery of the asset underlying the option (typically an equity security) will be automatically exercised at settlement. The options rule has detailed "contrary exercise advice" (CEA) procedures describing the manner in which an option holder can elect not to exercise an option that normally would be exercised, or exercise an option contract that normally would expire worthless. To prevent option holders from unfairly exploiting after-hours news or market information that affects the price of the underlying security, the CEA notices must be submitted to the broker-dealer and by the broker-dealer to the OCC by certain specified cut-off times. Occasionally, due to technical problems or other inadvertent errors, firms fail to submit CEA notices within the applicable time limits. In such instances, FINRA proposes to have the flexibility to treat these violations as minor rule violations. Violations of the CEA rules that exploit or are intended to exploit after-hours news would not be treated as minor rule violations.

Endnote

- 1 See Exchange Act Rel. No. 57935 (June 6, 2008), 73 F.R. 34061 (June 16, 2008) (SR-FINRA-2008-023).

©2008. FINRA. All rights reserved. *Regulatory Notices* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

ATTACHMENT A

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

* * * * *

9200. DISCIPLINARY PROCEEDINGS

* * * * *

IM-9216. Violations Appropriate for Disposition Under Plan Pursuant to SE[C]A Rule 19d-1(c)(2)

Any member of FINRA that is also a member of the New York Stock Exchange LLC (“NYSE”) (“Dual Member”) (including any persons affiliated with such member) may be subject to a fine under NASD 9216(b) with respect to any rule listed in this IM-9216 that applies to such member or person. However, any Dual Member that was not also a member of NASD as of July 30, 2007 and that does not engage in any activities that would have required it to be an NASD member (and its affiliated persons that are not otherwise subject to NASD rules) shall only be subject to a fine under NASD Rule 9216(b) with respect to the following rules listed in this IM-9216: any NYSE rule, SEC Exchange Act rule, NASD By-Law or Schedule to the By-Laws, or the NASD Rule 8000 Series.

Any member of FINRA that is not also a member of the NYSE (and its associated persons that are not otherwise subject to NYSE rules) may be subject to a fine under NASD Rule 9216(b) with respect to any rule listed in this IM-9216, with the exception of the NYSE rules.

- NASD Rules 2210, 2211, and 2220, and IM-2210-1, -2210-2, -2210-3, -2210-4, -2210-5, -2210-7, and -2210-8 — Communications with the public.
- NASD Rule 3360 — Failure to timely file reports of short positions on Form NS-1.
- NASD Rule 3110 — Failure to keep and preserve books, accounts, records, memoranda, and correspondence in conformance with all applicable laws, rules, regulations and statements of policy promulgated thereunder, and with NASD Rules.
- NASD Rules 8211 and 8213 — Failure to submit trading data as requested.

- Article IV of the NASD By-Laws — Failure to timely submit amendments to Form BD.
- Article V of the NASD By-Laws — Failure to timely submit amendments to Form U4.
- Article V of the NASD By-Laws — Failure to timely submit amendments to Form U5.
- NASD Rule 1120 — Failure to comply with the Firm Element of the continuing education requirements.
- NASD Rule 2860(b)(3) and (b)(4) – Failure to comply with options position and exercise limits.
- NASD Rule 2860(b)(23) – Failure to comply with contrary exercise advice procedures.
- NASD Rule 3010(b) — Failure to timely file reports pursuant to the Taping Rule.

* * * * *