

Regulatory Notice

10-03

Financial Responsibility and Operational Rules

FINRA Requests Comments on Proposed Consolidated FINRA Rules Governing Securities Loans and Borrowings, Permissible Use of Customers' Securities and Callable Securities

Comment Period Expires: March 8, 2010

Executive Summary

As part of the process of developing a new, consolidated rulebook (the Consolidated FINRA Rulebook),¹ FINRA is requesting comment on three proposed FINRA rules. Proposed FINRA Rule 4314 (Securities Loans and Borrowings) sets forth the requirements applicable to a member firm that is a party to an agreement for the loan or borrowing of securities. Proposed FINRA Rule 4330 (Customer Protection — Permissible Use of Customers' Securities) sets forth the requirements applicable to a member firm's borrowing or lending of a customer's margin securities that are eligible to be pledged or loaned. Proposed FINRA Rule 4340 (Callable Securities) sets forth the obligations applicable to any callable securities a member firm has in its possession or control.

The text of the proposed rules is set forth in Attachment A.

Questions regarding this *Notice* should be directed to:

- Kris Dailey, Vice President, Risk Oversight & Operational Regulation, at (646) 315-8434; or
- Yui Chan, Managing Director, Risk Oversight & Operational Regulation, at (646) 315-8426.

January 2010

Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management
- Systems

Key Topic(s)

- Books and Records
- Callable Securities
- Customer Funds and Securities
- Disclosure of Agency Capacity
- Lending and Borrowing Arrangements
- Liquidation
- Loan Consent Agreements
- Margin Securities
- Redemptions
- SIPC Protection

Referenced Rules & Notices

- NASD IM-2330
- NASD Rule 2330
- NYSE Rule 296
- NYSE Rule 402
- NYSE Rule 402.30
- NYSE Rule Interpretation 402(b)/01
- SEA Rule 15c3-3

Action Requested

FINRA encourages all interested parties to comment on the proposed rule. Comments must be received by March 8, 2010. Member firms and other interested parties can submit their comments using the following methods:

- Emailing comments to pubcom@finra.org; or
- Mailing comments in hard copy to:
Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, D.C. 20006-1506

To help FINRA process and review comments more efficiently, persons should only use one method to comment on the proposal.

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.²

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.³

Discussion

I. Proposed FINRA Rule 4314 (Securities Loans and Borrowings)

A. Background

NYSE Rule 296 (Liquidation of Securities Loans and Borrowings)⁴ sets forth the obligations of a member that is party to an agreement with another member for the loan and borrowing of securities. Specifically, the rule provides that a member that is party to an agreement with another member for the loan and borrowing of securities has the right to liquidate such transaction whenever the other party to the transaction:

- (1) applies for or consents to a receiver, custodian, trustee or liquidator of itself or 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 for a Chapter 11 bankruptcy filing or a protective decree under Section 5 of the Securities Investor Protection Act of 1970 (SIPA) (liquidation conditions).

The rule further provides that no member may lend or borrow any security to or from any non-member of the NYSE, except pursuant to a written agreement, which may consist of the exchange of contract confirmations, which confers upon the member the contractual right to liquidate such transaction because of a liquidation condition of the kind specified above.

NYSE Rule 296.10 defines the term “agreement for the loan and borrowing of securities,” for purposes of NYSE Rule 296. NYSE Rule 296.20 provides that each member that is subject to SEA Rule 15c3-3 and that borrows from a customer (as the term is defined in SEA Rule 15c3-3) must comply with Rule 15c3-3’s provisions requiring a written agreement between the borrowing member and the lending customer.

FINRA believes that the rule has been the basis for similar provisions incorporated in the industry standard Master Securities Lending Agreement (MSLA). Furthermore, FINRA believes that the rule provides protection to members that may enter into a securities lending transaction without a duly signed MSLA with a counterparty, should one of the counterparties become insolvent, allowing for the ability to immediately liquidate against collateral received.

FINRA proposes to adopt NYSE Rule 296 as FINRA Rule 4314 (Securities Loans and Borrowings) into the Consolidated FINRA Rulebook with the changes described below.

B. Proposed FINRA Rule 4314

In 2006, the industry began to adopt voluntary practices initiated by the SEC, including books and records and disclosure practices, as a result of an industry-wide initiative to address the risks associated with agency lending (the Agency Lending Disclosure Initiative). Consistent with the industry-wide initiative, FINRA is proposing a new requirement to address concerns about whether parties are acting as principals or agents when entering into an agreement to loan or borrow securities. The proposed rule requires a member firm that acts as agent in a loan or borrow transaction to disclose its capacity, and, in cases where the member firm lends securities to or borrows securities from a counterparty that is acting in an agency capacity, requires that the member firm maintain books and records to reflect the identity of both the agent and the principal(s) on whose behalf the agent is acting and the contract terms between the parties.

Specifically, proposed new FINRA Rule 4314(a) requires a member firm that enters into a transaction to lend or borrow securities as agent to disclose its capacity to the other party (or parties) to the transaction. The provision further requires the member firm, prior to lending securities to or borrowing securities from a person that is not a member of FINRA, to determine whether the other party is acting as principal or agent in the transaction. When the other party (who may or may not be a member) is acting as agent in the transaction, the member firm is required to maintain books and records that: (1) reflect the details of the transaction with each such agent; and (2) reflect each principal(s) on whose behalf the agent is acting and the details of each transaction therewith.

Proposed FINRA Rule 4314(b), based on NYSE Rule 296(a), continues to provide each member firm that is a party to an agreement with another member firm for the loan and borrowing of securities with the right to liquidate such transaction whenever the other party to such transaction becomes subject to one of the liquidation conditions specified in the rule.

In addition, FINRA is proposing to expand upon the written agreement requirement in NYSE Rule 296(b). Specifically, proposed FINRA Rule 4314(c) requires that no member firm shall lend or borrow securities to or from any person that is not a member of FINRA, except pursuant to a written agreement, which may consist of the exchange of contract confirmations, which confers upon such member the contractual right to liquidate such transaction because of a liquidation condition of the kind specified in proposed FINRA Rule 4314(b), as detailed above. In contrast, NYSE Rule 296(b) requires a member to have a written agreement only with any non-member of the NYSE. FINRA believes that expanding the requirement to have a written agreement with all non-members of FINRA, including any customer, protects the member firm's interests in the event of a liquidation condition specified in proposed FINRA Rule 4314(b) and supports the member's compliance with net capital requirements.

Further, FINRA is proposing to transfer NYSE Rule 296.10, which defines the term "agreement for the loan and borrowing of securities," as Supplementary Material .01 to proposed FINRA Rule 4314, without substantive change. In addition, FINRA is proposing to add new Supplementary Material .02 through .04 to the proposed FINRA rule. Proposed Supplementary Material .02 clarifies the methods by which a member firm may satisfy its disclosure obligation in new paragraph (a) 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 transaction between the parties. Proposed Supplementary Material .03 clarifies the books and records requirements imposed by new paragraph (a). Proposed Supplementary Material .04 reminds member firms of their obligations under proposed FINRA Rule 4330(b) (discussed further below) to provide a written notice when borrowing securities from customers regarding the associated risks of such transactions, and requires that member firms disclose in such written notice their right to liquidate under the conditions specified in paragraph (c) of proposed FINRA Rule 4314.

C. Eliminated Rules and Requirements

FINRA is proposing to eliminate existing NYSE Rule 296.20, which, as discussed above, requires each member firm that is subject to the provisions of SEA Rule 15c3-3 and that borrows securities from a customer to comply with the provisions relating to the requirements for a written agreement between the borrowing member and the lending customer, as the substance of this provision has been included in proposed FINRA Rule 4330(b).

FINRA is also proposing to eliminate NYSE Rule Interpretation 296(b)/01, which addresses transactions with non-member organizations and the written agreements required in regard to repurchase and reverse repurchase transactions not subject to SEA Rule 15c3-3, as the interpretation is beyond the scope of the proposed rule.

II. Proposed FINRA Rule 4330 (Customer Protection—Permissible Use of Customers' Securities)

A. Background

NYSE Rule 402(a)-(b) (Customer Protection—Reserves and Custody of Securities), NASD Rule 2330(b)-(d) (Customers' Securities or Funds) and NASD IM-2330 (Segregation of Customers' Securities) set forth the requirements applicable to a member firm's use of customers' securities. Specifically, NYSE Rule 402 and NASD Rule 2330 prohibit a member firm from lending, either to itself or others, securities that are held on margin for a customer and that are eligible to be pledged or loaned, unless the firm first obtains a written authorization from the customer permitting the lending of the customer's securities. NYSE Rule Interpretation 402(b)/01 (Agreements for Use of Customers' Securities/Application) permits a member firm to use a single customer-signed margin agreement/loan consent in lieu of obtaining separate written documents. Both the NYSE and NASD rules contain similar provisions requiring members to comply with SEA Rule 15c3-3 in obtaining custody and control of securities and maintaining appropriate cash reserves.

FINRA proposes to adopt NYSE Rule 402 as FINRA Rule 4330 (Customer Protection—Permissible Use of Customers' Securities), subject to certain significant changes, and eliminate NASD Rule 2330(b)-(d) and NASD IM-2330 as duplicative or otherwise unnecessary.

B. Proposed FINRA Rule 4330(a) (Authorization to Lend Customers' Margin Securities)

Proposed FINRA Rule 4330(a) continues to require a member firm to obtain a customer's written authorization prior to lending the customer's eligible margin securities. Also, proposed supplementary material retains and codifies NYSE Rule Interpretation 402(b)/01, thereby continuing to permit a member firm to satisfy the written authorization requirement by using a single customer-signed margin agreement/loan consent, provided that it contains a legend in bold type face placed directly above the signature line that states:

"BY SIGNING THIS AGREEMENT I ACKNOWLEDGE THAT MY SECURITIES MAY BE LOANED TO YOU OR LOANED OUT TO OTHERS."

C. Proposed FINRA Rule 4330(b) (Requirements for Borrowing of Customers' Fully Paid or Excess Margin Securities)

Additionally, FINRA is proposing new requirements to address the increase in the borrowing and lending of customers' fully paid or excess margin securities. Specifically, proposed FINRA Rule 4330(b)(1) requires a member firm to notify FINRA, in such manner and format as FINRA may require, at least 30 days prior to engaging in such activities. FINRA may request related information, including the written agreement authorizing such arrangements, the types of customers, the accounts used and the collateral involved in the transactions.

Proposed FINRA Rule 4330(b)(2) also imposes a new requirement that a member firm, prior to entering into a securities borrow transaction with a customer, provide the customer, in writing (which may be electronic), with a clear and prominent notice that the provisions of SIPA may not protect the customer with respect to such transaction and that the collateral delivered to the customer may constitute the only source of satisfaction of the member firm's obligation in the event the member firm fails to return the securities. In addition, a member firm would be required to provide the customer with information regarding risks associated with the transaction (*e.g.*, the potential loss of SIPC protection as described above, a loss of voting rights, possible limitations on the ability to sell the borrowed securities); the economics of the transaction, including potential tax implications; and the member firm's right to liquidate the transaction because of a condition of the kind specified in proposed FINRA Rule 4314(b) (Securities Loans and Borrowings—Right to Liquidate Transaction) (discussed above).

Additionally, proposed FINRA Rule 4330(b)(2) requires for the first time that a member firm determine whether the transaction is suitable for the customer. However, proposed supplementary material, while clarifying that the member firm borrowing a customer's securities is responsible for making the suitability determination regarding the customer, permits the member firm to rely on any representations made by another member firm that has a customer relationship with the lender. Proposed FINRA Rule 4330(b)(3) also requires that a member maintain books and records evidencing compliance with proposed FINRA Rule 4330(b)(2).

D. Eliminated Rules and Requirements

Proposed FINRA Rule 4330 does not retain the provisions in NYSE Rule 402 that are duplicative of the requirements in SEA Rule 15c3-3 or the outdated provisions regarding the physical segregation of securities. Additionally, the proposed rule change eliminates NASD Rule 2330(b)-(d) and NASD IM-2330, which contain similar duplicative and outdated provisions.

III. Proposed FINRA Rule 4340 (Callable Securities)

A. Background

NYSE Rule 402.30 (Securities Callable in Part) requires a member firm that has in its possession or control securities that are callable in part to identify each such security so that its records clearly show for whose account it is held. The following securities are exempt from this requirement:

- (1) certain bonds that have not paid interest for at least two interest periods;
- (2) Euro-dollar bonds deposited in a central clearing facility for such bonds, provided that customers are notified of the deposit into the central clearing facility and also that the member has the right to withdraw uncalled bonds from the facility at any time; and
- (3) bonds or preferred stocks, provided that the member has satisfied certain requirements, including adopting an impartial lottery system in which the probability of a customer's bonds or preferred stocks being selected as called is proportional to the holdings of all customers of such securities held in bulk by or for the member firm.

NYSE Rule 402.30 also requires that a member firm provide written disclosure to all customers of the systems and the manner in which securities are held and their rights to withdraw uncalled securities, as described above, prior to: (1) the member depositing the securities in bulk; or (2) the customer purchasing such securities, except in the case of a new account, provided that such notice was sent to the customer prior to the settlement date. The rule further requires that in the event of a favorable call of the securities, the member shall not allocate any securities to any account in which it or its general, limited, or special partners, officers, directors, approved persons or employees have an interest until all other customers' positions in the securities have been satisfied. There is no comparable NASD rule.

FINRA proposes to adopt FINRA Rule 4340 (Callable Securities), based in part on NYSE Rule 402.30. The proposed rule changes are detailed further below.

B. Proposed FINRA Rule 4340(a): Allocation Procedures and Customer Notice

Proposed FINRA Rule 4340(a) retains in concept the provision in NYSE Rule 402.30 requiring each member firm that has in its possession or control certain callable securities to establish procedures by which it will allocate among its customers the shares to be redeemed or selected as called in the event of a partial redemption or call. However, proposed FINRA Rule 4340(a) applies this provision to any security, which by its terms, may be called or redeemed prior to maturity.

The proposal eliminates the specific requirements in NYSE Rule 402.30 regarding the establishment of an impartial lottery system in which the probability of a customer's securities being selected as called is proportional to the holdings of all customers of such securities held in bulk by the member firm. Instead, proposed FINRA Rule 4340(a) adopts a more flexible approach and allows member firms to establish procedures that require the allocation to be conducted on a fair and impartial basis. Proposed supplementary material clarifies that such 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.

Proposed FINRA Rule 4340(a) also requires the member firm to post its allocation procedures on its Web site and provide written notice (which may be electronic) to new customers at the opening of an account, and to all customers at least once every calendar year, explaining how customers may access the procedures on the member's Web site and that, upon a customer's request, the member will provide hard copies of the allocation procedures to the customer.

C. Proposed FINRA Rule 4340(b) and (c): Favorable and Unfavorable Redemptions

Proposed FINRA Rule 4340(b) retains in concept the restriction in NYSE Rule 402.30 prohibiting a member firm from allocating securities to any of its accounts or those of its "employees, partners, officers, directors, and approved persons" in a redemption offered on terms favorable to a customer until all other customers' positions have been satisfied. However, proposed FINRA Rule 4340(b) applies the restriction to a member and its "associated persons," rather than to a member's "employees, partners, officers, directors, and approved persons."

Proposed supplementary material clarifies that the term “associated person” as used in the proposed rule would have the meaning provided in Exchange Act Section 3(a)(18), which expressly excludes for certain purposes any persons associated with the member firm whose functions are solely clerical or ministerial (referred to as “clerical and ministerial associated persons”).⁵ Proposed supplementary material also makes clear that, in the event of a redemption offered on terms favorable to a customer, a member firm may include the accounts of clerical and ministerial associated persons in the pool of securities eligible to be called. However, where the redemption of callable securities is offered on terms unfavorable to a customer, proposed FINRA Rule 4340(c) expressly prohibits a member firm from excluding its accounts and those of its associated persons, including the accounts of clerical and ministerial associated persons, from the pool of securities eligible to be called.

Additionally, proposed supplementary material codifies that where an introducing member firm is a party to a carrying agreement with another member firm that is conducting an allocation pursuant to proposed FINRA Rule 4340(a), any account in which the introducing member firm or its associated persons have an interest shall be subject to the provisions regarding participation in favorable and unfavorable calls or redemptions. In addition, the introducing member firm must identify such accounts to the member firm conducting the allocation.

D. Eliminated Rules and Requirements

Finally, the proposed rule change eliminates NYSE Rule 402.30 in its entirety, including eliminating as unnecessary the rule’s provision permitting customers to withdraw uncalled fully paid securities at any time prior to a partial call, and also to withdraw excess margin securities, provided that the customers’ accounts are not subject to restrictions under Regulation T, or such withdrawals will not cause an under-margined condition.

Endnotes

- 1 The current FINRA rulebook consists of 1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA member firms, the Incorporated NYSE Rules apply only to those member firms of FINRA that are also members of the NYSE (Dual Members). The FINRA Rules apply to all FINRA member firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see *Information Notice 3/12/08* (Rulebook Consolidation Process).
- 2 FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
- 3 Section 19 of the Securities Exchange Act of 1934 (SEA or Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See SEA Section 19 and rules thereunder.
- 4 For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.
- 5 Although the FINRA By-Laws define associated persons, FINRA is proposing the Exchange Act definition of “associated person” to permit members to include accounts held by clerical and ministerial persons in favorable calls or redemptions.

Attachment A

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

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Text of Proposed New FINRA Rules

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4000. FINANCIAL AND OPERATIONAL RULES

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4300. OPERATIONS

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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) With respect to paragraphs (a)(1) and (2) above, when the other party to a security loan or borrow transaction is acting as agent in such transaction, the member shall:

(A) maintain books and records that reflect the details of the transaction with each such agent; and

(B) maintain books and records that reflect 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 that right 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.

• • • 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 Acting as Agents. 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 each agent, identifying the specific security and quantity loaned or borrowed, the contract value and the type and description of the collateral provided to such 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. Such records shall be maintained in accordance with the requirements of SEA Rule 17a-4(a).

.04 Compliance with Rule 4330 When Borrowing Securities from a Customer. When a member borrows securities from a customer, the member is also subject to Rule 4330(b)(2)(A)(ii), which requires members to provide information to customers regarding the risks associated with the customer's securities loan transaction. 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 (c) of this Rule.

[.20 Each member or member organization subject to the provisions of 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 comply with the requirements of SEA Rule 15c3-3 and shall notify FINRA, in such manner and format as FINRA may require, at least 30 days prior to engaging in such borrow activities.

(2) A member that engages in borrow activities pursuant to paragraph (b)(1) of this Rule shall, prior to entering into a securities borrow transaction with a customer:

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

(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) information regarding the risks associated with the customer's securities loan transaction, including but not limited to:

- a. potential loss of SIPC protection as described in paragraph (b)(2)(A)(i) of this Rule;
- b. loss of voting rights;
- c. the type and sufficiency of collateral provided to the customer;
- d. any limitations on the customer's ability to sell the loaned securities, if applicable;

e. the economics of the transaction, including potential tax implications, as applicable; and

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

(B) determine that such transaction is suitable for the customer.

(3) A member that engages in borrow activities pursuant 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.

• • • 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 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. Such margin agreement/loan consent must contain a legend in bold type face placed directly above the signature line that states substantially the following:

"BY SIGNING THIS AGREEMENT I ACKNOWLEDGE THAT MY SECURITIES MAY BE LOANED TO YOU OR LOANED OUT TO OTHERS."

.03 Notification to FINRA. FINRA, upon receipt of a member's written notification pursuant to paragraph (b)(1) of this Rule of the member's intent to engage in such borrow activities, may request such additional information as it may deem necessary to evaluate compliance with SEA Rule 15c3-3 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 arrangements;

(c) the types of accounts used to effect such transactions (i.e., whether the subject securities are contained in customers' cash or margin accounts or separate accounts);

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

(e) net capital compliance of such transactions;

(f) the operational and recordkeeping processes related to such transactions;

(g) the rebates paid/received in connection with such transactions and any other compensation arrangements related thereto; or

(h) the procedures for handling customers' requests to sell the fully paid or excess margin securities subject to such transactions; and

(i) any applicable disclosure requirements.

.04 Suitability Determination. The member borrowing a customer's fully paid or excess margin securities is responsible for making the suitability determination regarding the customer required by paragraph (b)(2)(B) of this Rule. However, in making that determination, the member may rely on the representations of another member that has a customer relationship with the lender.

[.30 Securities Callable in Part]

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4340. Callable Securities

(a) Each member that has in its possession or 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 Web site procedures by which it will allocate among its customers, on a fair and impartial basis, the shares to be redeemed or selected as called in the event of a partial redemption or call; and

(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 Web site and that, upon a customer's request, the member will provide hard copies of the allocation procedures to the customer.

(b) Where redemption of callable securities is offered on terms favorable to a customer, 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) Where the redemption of callable securities is made on unfavorable terms to a customer, 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 offered on terms favorable to a customer, 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 offered on unfavorable terms to a customer, 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.