

## SEC Approves New Consolidated FINRA Rule

### SEC Approval and Effective Date for New Consolidated FINRA Rule

Effective Date: October 15, 2010

#### Executive Summary

Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA established a process to develop a new consolidated rulebook (Consolidated FINRA Rulebook), which FINRA has discussed in previous *Information Notices*.<sup>1</sup> FINRA is proposing new consolidated rules in phases for approval by the Securities and Exchange Commission (SEC) as part of the Consolidated FINRA Rulebook.<sup>2</sup> In June and July, the SEC approved five new consolidated FINRA Rules.<sup>3</sup> This *Regulatory Notice* specifically addresses the approval and effective date of new FINRA Rule 4320 (Short Sale Delivery Requirements).<sup>4</sup>

Text of new FINRA Rule 4320 is available in the online *FINRA Manual* at [www.finra.org/finramanual/rules/r4320](http://www.finra.org/finramanual/rules/r4320).<sup>5</sup>

Questions regarding this *Notice* should be directed to Racquel Russell, Assistant General Counsel, Office of General Counsel, at (202) 728-8363.

#### August 2010

##### Notice Type

- Consolidated Rulebook
- Rule Approval

##### Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management
- Trading and Market Making

##### Key Topics

- Short Sale Delivery
- Short Sales

##### Referenced Rules & Notices

- FINRA Rule 4320
- Information Notice 03/12/08
- Information Notice 10/06/08
- Regulatory Notice 08-57
- Regulation SHO

## Background & Discussion

On July 20, 2010, the SEC approved a FINRA proposed rule change to adopt NASD Rule 3210, with minor changes, as FINRA Rule 4320 in the Consolidated FINRA Rulebook.<sup>6</sup> FINRA Rule 4320 applies short sale delivery requirements to equity securities not otherwise covered by the close-out requirements of Regulation SHO.<sup>7</sup> Among other things, FINRA Rule 4320 requires participants of registered clearing agencies to take action on failures to deliver that exist for 13 consecutive settlement days in certain non-reporting securities. In addition, if the fail to deliver position is not closed out in the requisite time period, a participant of a registered clearing agency or any broker-dealer for which it clears transactions is prohibited from effecting further short sales in the particular specified security without borrowing, or entering into a bona fide arrangement to borrow, the security until the fail to deliver position is closed out.<sup>8</sup>

With a few exceptions, new FINRA Rule 4320 is identical to former NASD Rule 3210, and the changes made to the text do not alter the operation and application of the rule. For example, the new FINRA rule omits language that provided allowances for “grandfathered” securities during the initial implementation period of NASD Rule 3210 which no longer is relevant. In addition, FINRA Rule 4320 clarifies, consistent with Regulation SHO, the borrowing requirements for clearing agency participants—including broker-dealers for which they clear transactions—that sell short non-reporting threshold securities for which a fail to deliver position has not been closed out in the requisite time.<sup>9</sup>

In addition, FINRA will apply to FINRA Rule 4320 all interpretive positions issued by the SEC and its staff with respect to the parallel provisions of Regulation SHO (*i.e.*, Rule 203(b)(3) of Regulation SHO), as was the case with NASD Rule 3210. Therefore, FINRA continues to expect firms to observe all interpretive views issued by the SEC and its staff with respect to Rule 203(b)(3) and apply such positions to FINRA Rule 4320.<sup>10</sup>

## Rule Conversion Charts

As discussed in additional detail in *Information Notice 10/06/08* and *Regulatory Notice 08-57*, FINRA has posted three Rule Conversion Charts on its website to help firms become familiar with the new rules and show how the new rules relate to the NASD and/or Incorporated NYSE Rules in the Transitional Rulebook that they will replace.

**Firms should be aware that the charts are intended as a reference aid only.** FINRA reminds firms that the charts do not in any way serve as a substitute for diligent review of the relevant new rule language. The Rule Conversion Charts are located at [www.finra.org/ruleconversionchart](http://www.finra.org/ruleconversionchart).

## Endnotes

- 1 *See Information Notice 10/06/08* (Rulebook Consolidation Process: Effective Dates of New Consolidated Rules; Introduction of Rule Conversion Chart); *see also Information Notice 03/12/08* (Rulebook Consolidation Process).
- 2 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 members of FINRA that are also members of the NYSE (Dual Members). The new FINRA Rules apply to all member firms, unless such rules have a more limited application by their terms. As the Consolidated FINRA Rulebook expands with the SEC's approval and with the new FINRA Rules taking effect, the rules in the Transitional Rulebook that address the same subject matter of regulation will be eliminated. When the Consolidated FINRA Rulebook is completed, the Transitional Rulebook will have been eliminated in its entirety.
- 3 In July 2010, the SEC approved three FINRA proposed rule changes to adopt five new rules in the Consolidated FINRA Rulebook. *See Securities Exchange Act Release No. 62482* (July 12, 2010), 75 FR 41562 (July 16, 2010) (SR-FINRA-2010-024); *Securities Exchange Act Release No. 62533* (July 20, 2010), 75 FR 43588 (July 26, 2010) (SR-FINRA-2010-028); and *Securities Exchange Act Release No. 62539* (July 21, 2010), 75 FR 44033 (July 27, 2010) (SR-FINRA-2010-029).
- 4 *See Securities Exchange Act Release No. 62533* (July 20, 2010), 75 FR 43588 (July 26, 2010) (SR-FINRA-2010-028). FINRA will issue separate *Regulatory Notices* announcing the effective dates of the approved rules set forth in SR-FINRA-2010-024 and SR-FINRA-2010-029. *See supra* note 3.
- 5 FINRA updates the rule text on its online *Manual* within two business days of SEC approval of changes to the rule text.
- 6 *See Securities Exchange Act Release No. 62533* (July 20, 2010), 75 FR 43588 (July 26, 2010) (SR-FINRA-2010-028).
- 7 The Regulation SHO close-out requirements apply only to "reporting" securities (*i.e.*, issuers that are registered pursuant to Section 12 of the Exchange Act or that are required to file reports pursuant to Section 15(d) of the Exchange Act).
- 8 In July 2009, the SEC adopted Rule 204 under Regulation SHO as a permanent rule. This rule is intended to further the goal of reducing fails to deliver and addressing potentially abusive "naked" short selling in all equity securities by requiring the delivery of securities by settlement date or, in connection with a short sale, the immediate purchase or borrow of such securities to close out the fail to deliver position by no later than the beginning of regular trading hours on the following settlement day.  
  
Notwithstanding the SEC's adoption of Rule 204, the provisions of NASD Rule 3210 continue to be necessary to provide regulatory coverage for fails to deliver in non-reporting over-the-counter equity securities that pre-exist the SEC's implementation of temporary Rule 204 in September 2008. Thus, FINRA has adopted NASD Rule 3210 with minor changes as FINRA Rule 4320.

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## Endnotes continued

- 9 Specifically, if a fail to deliver position is not closed out in accordance with FINRA Rule 4320(a), the clearing agency participant and any broker-dealer for which it clears, including market makers otherwise entitled to rely on the Rule 203(b)(2)(iii) exception of Regulation SHO, would not be able to short sell the non-reporting threshold security either for itself or for the account of another, unless it has previously arranged to borrow or borrowed the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.
- 10 For example, with respect to the requirement that participants “immediately” close out a fail to deliver position by purchasing securities of like kind and quantity, the SEC has clarified that “immediately” should be interpreted to mean that close out is required no later than the morning of the fourteenth business day. Likewise FINRA expects that, under FINRA Rule 4320, firms “immediately” close out fail to deliver positions no later than the morning of the fourteenth business day.