

Regulatory Notice

10-45

Margin and Extension of Time Requests

SEC Approval and Effective Date for New Consolidated FINRA Rules Regarding Margin Requirements, Daily Record of Required Margin, and Extension of Time Requests

Effective Date: December 2, 2010

Executive Summary

FINRA's rule change¹ to adopt consolidated rules regarding margin requirements, daily record of required margin and extension of time requests under Regulation T and SEA Rule 15c3-3 for the Consolidated FINRA Rulebook² becomes effective December 2, 2010.

The new FINRA rules are based on and replace provisions in the NASD and Incorporated NYSE Rules.³ The new rules also clarify that a firm must take into account the special deductions from net capital set forth in FINRA Rule 4210 (Margin Requirements) in determining its status under FINRA Rule 4120 (Regulatory Notification and Business Curtailment).⁴

This *Notice* also announces the adoption of the Incorporated NYSE Rule 431 Interpretations, subject to certain amendments, as interpretations to FINRA Rule 4210, which also become effective December 2, 2010.

The text of the new rules is in Attachment A on our website at www.finra.org/notices/10-45. The FINRA Rule 4210 interpretations are available at www.finra.org/rules/4210interpretations.

October 2010

Notice Type

- Consolidated Rulebook
- Rule Approval

Suggested Routing

- Compliance
- Institutional
- Legal
- Margin
- Operations
- Regulatory Reporting
- Senior Management
- Systems
- Trading

Key Topic(s)

- Extension of Time Requests
- Margin
- Regulation T
- SEA Rule 15c3-3

Referenced Rules & Notices

- FINRA Rule 2360
- FINRA Rule 2370
- FINRA Rule 4110
- FINRA Rule 4120
- FINRA Rule 4210
- FINRA Rule 4220
- FINRA Rule 4230
- SEA Rule 15c3-3



Financial Industry Regulatory Authority

Questions concerning this *Notice* should be directed to:

- Rudolph R. Verra, Managing Director, Risk Oversight and Operational Regulation, at (646) 315-8811;
- Glen Garofalo, Director, Credit Regulation, at (646) 315-8464;
- Steve Yannolo, Principal Credit Specialist, Credit Regulation, at (646) 315-8621; or
- Kathryn Moore, Assistant General Counsel, Office of General Counsel, at (202) 974-2974.

Background and Discussion

A. FINRA Rule 4210 (Margin Requirements)

FINRA has adopted the requirements set forth in NASD Rule 2520 (Margin Requirements) and related NASD margin rules and interpretations (NASD Rules 2521, 2522 and IM-2522), subject to certain amendments discussed below, as new FINRA Rule 4210 (Margin Requirements).

The amendments, among other things, reflect certain requirements in Incorporated NYSE Rule 431 (Margin Requirements). FINRA Rule 4210, like its predecessor rules, prescribes requirements governing the extension of credit by firms that offer margin accounts to customers, as permitted in accordance with Regulation T of the Board of Governors of the Federal Reserve System (Regulation T).⁵ The rule promulgates the margin requirements that determine the amount of collateral customers are expected to maintain in their margin accounts, including strategy-based margin accounts and portfolio margin accounts. Maintenance margin requirements for equity, fixed income, warrants and option securities are also established under the rule.

Rule Structure

FINRA has restructured the consolidated rule to improve its organization and make it easier to read. FINRA Rule 4210(h) provides that any firm for which another self-regulatory organization acts as the designated examining authority is exempt from FINRA Rule 4210.

In addition, FINRA Rule 4210(f)(2)(A) contains streamlined definitions for margining options, currency warrants, currency index warrants and stock index warrant transactions. FINRA also combined the margin provisions regarding currency warrants, currency index warrants and stock index warrants from NASD Rule 2520(f)(10) together with similar sections in paragraph (f)(2) of FINRA Rule 4210.

Finally, the supplementary material to FINRA Rule 4210 provides illustrations on how to calculate the number of elapsed days for accrued interest on Treasury bonds or notes.

Net Capital Calculations

In certain instances, FINRA Rule 4210 specifies that firms should reference SEA Rule 15c3-1 and, if applicable, FINRA Rule 4110 (Capital Compliance), when computing net capital charges against net capital and haircut requirements.⁶ Firms may be subject to greater net capital requirements pursuant to the provisions of paragraph (c) of FINRA Rule 4110.

Joint Accounts Exemption

FINRA integrated Incorporated NYSE Rule 431 Supplementary Material .10 into FINRA Rule 4210(e)(3) regarding joint accounts in which the carrying firm or a partner or stockholder has an interest. The provision permits a firm to seek an exemption under the FINRA Rule 9600 Series if the account is confined exclusively to transactions and positions in exempted securities. FINRA Rule 4210(e)(3) provides the required information to be included in any such application.

Additional Requirements on Control and Restricted Securities and Relationship to FINRA Rule 4120

FINRA adopted provisions from Incorporated NYSE Rule 431 pertaining to deductions from net capital on control and restricted securities. These provisions, set forth in FINRA Rule 4210(e)(8)(C)(ii), (iii) and (v), require that a firm make deductions from its net capital if it extends credit over specified thresholds on control and restricted securities, and it must take such deductions into account when determining if it has reached any of the financial triggers specified in FINRA Rule 4120 (Regulatory Notification and Business Curtailment).⁷ The rule change also made conforming amendments to FINRA Rule 4120(a)(1)(F) and (c)(1)(F) to clarify that a firm must take into account the special deductions from net capital set forth in FINRA Rule 4210(e)(8)(C) in determining its status under FINRA Rule 4120.

Day Trading

FINRA integrated Supplementary Material .60 from Incorporated NYSE Rule 431 in FINRA Rule 4210(f)(8)(B)(iii) to provide that the day-trading buying power for non-equity securities may be computed using the applicable special maintenance margin requirements pursuant to other provisions of the margin rule. In addition, FINRA adopted Supplementary Material .30 from Incorporated NYSE Rule 431 as FINRA Rule 4210(f)(8)(B)(iv)b. to provide that in the event that the firm at which a customer seeks to open an account or resume day trading in an existing account knows or has a reasonable basis to believe that the customer will engage in pattern day trading, then the minimum equity requirement of \$25,000 must be deposited in the account prior to commencement of day trading.

Portfolio Margining

FINRA amended FINRA Rule 4210(g)(5)(B) to highlight that portfolio margin-eligible participants, in addition to being required to be approved to engage in uncovered short option contracts pursuant to FINRA Rule 2360 (Options), must be approved to engage in security futures transactions pursuant to FINRA Rule 2370 (Security Futures), if eligible participants engage in such transactions.

Conforming Amendments

FINRA added the terms “approved market maker,” “market maker” and “market making” to FINRA Rule 4210(f)(10)(F) to conform to rule changes made by the NYSE.⁸ The NYSE changes were made in connection with the operation of the NYSE’s Market Model.⁹ As a result of the implementation of these changes, the NYSE amended several of its rules, including NYSE Rule 431(f)(10)(F), to add the terms “approved market maker,” “market maker” and “market making” to reflect the current Designated Market Makers operating on the NYSE. FINRA amended the definitions of the same terms used in FINRA Rule 4210(e)(5)(A) and (f)(10)(E) for consistency purposes.

Clarifying and Technical Amendments

Finally, FINRA made several technical changes to the margin rule text to update terminology and similar clarifications. First, FINRA added definitions regarding “listed” and “OTC” options.

Second, in FINRA Rule 4210(f)(2)(i)(iv), FINRA made several clarifications to terminology where no margin may be required if the specified options or warrants are carried “short” in the account of a customer, against an escrow agreement, and either are held in the account at the time the options or warrants are written or received in the account promptly thereafter. The rule change clarified that with respect to such options or warrants, an escrow agreement is used, in a form satisfactory to FINRA, issued by a third-party custodian bank or trust company, and in compliance with the requirements of Rule 610 of The Options Clearing Corporation.

The rule change also replaced the term “guarantor” with the term “custodian” to more accurately reflect the third party’s role. In addition, the rule change revised the definition of what constitutes a qualified security by eliminating the reference to the list of Over-the-Counter Margin Stocks published by the Board of Governors of the Federal Reserve System as the Federal Reserve no longer publishes such a list.

Margin Interpretations

FINRA is also adopting Incorporated NYSE Rule 431 Interpretations, subject to certain amendments, as interpretations to FINRA Rule 4210. The FINRA Rule 4210 interpretations, which become effective on December 2, 2010, are available on our website at www.finra.org/rules/4210interpretations.

B. FINRA Rule 4220 (Daily Record of Required Margin)

FINRA adopted Incorporated NYSE Rule 432(a) (Daily Record of Required Margin) as FINRA Rule 4220 in substantially the same form. The rule sets forth the requirements for daily recordkeeping of initial and maintenance margin calls that are issued pursuant to Regulation T and the margin rules.

C. FINRA Rule 4230 (Required Submissions of Requests for Extension of Time Under Regulation T and SEA Rule 15c3-3)

FINRA adopted NASD Rule 3160 (Extensions of Time Under Regulation T and SEC Rule 15c3-3) as FINRA Rule 4230. FINRA added a provision to FINRA Rule 4230 to clarify that for the months when no broker-dealer for which a clearing firm clears exceeds the extension-of-time ratio criteria specified by FINRA (currently set at 2 percent), the clearing firm must submit a report indicating such.

As noted above, the new rules become effective December 2, 2010.

Endnotes

- 1 See Securities Exchange Act Release No. 62482 (July 12, 2010) 75 FR 41562 (July 16, 2010) (SEC Order Granting Approval to File No. SR-FINRA-2010-024).
- 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 FINRA Rules apply to all FINRA 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).
- 3 Effective December 2, 2010, NASD Rules 2520, 2521, 2522 and 3160; NASD IM-2522; Incorporated NYSE Rules 431, 432 and 434; and all Incorporated NYSE Rule 431 Interpretations will be deleted from the Transitional Rulebook.
- 4 FINRA notes that, in devoting this *Notice* to announcing the effective date of a single set of rules and rule amendments, it is deviating from the protocol by which FINRA generally announces the effective dates of the new FINRA rules that are being adopted as part of the consolidated rulebook. See *Information Notice 10/06/08* (Rulebook Consolidation Process: Effective Dates of New Consolidated Rules; Introduction of Rule Conversion Chart). FINRA believes that a single *Notice* devoted to the new margin and extension of time request rules is warranted in view of the regulatory subject matter.

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Endnotes continued

- 5 *See* Regulation T Section 220.4.
- 6 *See, e.g.*, FINRA Rule 4210(e)(2)(D), (e)(2)(F), (e)(2)(G), (e)(4), (e)(5) and (e)(6).
- 7 *See Regulatory Notice 09-71* (SEC Approves Consolidated FINRA Rules Governing Financial Responsibility) (December 2009) regarding FINRA Rule 4120.
- 8 *See* Securities Exchange Act Release No. 59077 (December 10, 2008) 73 FR 76691 (December 17, 2008) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change by New York Stock Exchange LLC Amending Exchange Rule 104T to Make a Technical Amendment to Delete Language Relating to Orders Received by NYSE Systems and DMM Yielding; Clarifying the Duration of the Provisions of Rule 104T; Making Technical Amendments to Rule 98 and Rule 123E to Update Rule References for DMM Net Capital Requirements; Rescinding Paragraph (g) of Rule 123; and Making Conforming Changes to Certain Exchange Rules to Replace the Term “Specialist” with “DMM”; File No. SR-NYSE-2008-127).
- 9 *See* Securities Exchange Act Release No. 58845 (October 24, 2008), 73 FR 64379 (October 29, 2008) (SEC Approval Order of SR-NYSE-2008-46 approving certain rules to operate as a pilot scheduled to end October 1, 2009.) *See also* Securities Exchange Act Release No. 60756 (October 1, 2009), 74 FR 51628 (October 7, 2009) (SR-NYSE-2009-100); Securities Exchange Act Release No. 61031 (November 19, 2009), 74 FR 62368 (November 27, 2009); and Securities Exchange Act Release No. 61724 (March 17, 2010), 75 FR 14221 (March 24, 2010) (extending the operation of the pilot until the earlier of SEC approval to make permanent or September 30, 2010). As part of this new model, the functions formerly carried out by specialists on the NYSE were replaced by a new market participant, known as a Designated Market Maker (DMM).