OMB APPROVAL	
OMB Number:	3235-0045
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Estimated average burden hours per response	38

Page 1 of 34

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2009 - 012
Amendment No.

Proposed Rule Change by Financial Industry Regulatory Authority

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial	Amendment	Withdrawal	Section 19(b)(2)	Section 19(b)(3)(A)	Section 19(b)(3)(B)
☑	☐	☐	☑	☐	☐

Pilot ☐

Extension of Time Period for Commission Action ☐

Date Expires

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Proposed Rule Change Relating to Margin Requirements for Certain Transactions in Credit Default Swaps

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name: Adam Last Name: Arkel
Title: Assistant General Counsel
E-mail: adam.arkel@finra.org
Telephone: (202) 728-6961 Fax: (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 03/11/2009

By Marc Menchel (Name)

Executive Vice President and General Counsel (Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Marc Menchel, marc.menchel@finra.org

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Exhibit Sent As Paper Document ☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document ☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to adopt FINRA Rule 4240 (Margin Requirements for Credit Default Swaps). The proposed rule would implement an interim pilot program with respect to margin requirements for transactions in credit default swaps executed by a member (regardless of the type of account in which the transaction is booked), including those in which the offsetting matching hedging transactions are effected by the member in credit default swap contracts that are cleared through the central counterparty clearing services of the Chicago Mercantile Exchange. The proposed rule would expire on September 25, 2009.

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on February 11, 2009, the FINRA Board of Governors authorized the filing of the rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

The proposed rule change shall become effective upon approval by the SEC. FINRA will announce the approval of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval, but FINRA does

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[1] 15 U.S.C. 78s(b)(1).

intend to issue such Regulatory Notice as soon as practicable in the event of SEC approval of the proposed rule change given the limited time period of the proposed interim pilot program.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

FINRA is proposing to adopt FINRA Rule 4240 (Margin Requirements for Credit Default Swaps). The proposed rule would implement an interim pilot program (the "Interim Pilot Program") with respect to margin requirements for transactions in credit default swaps ("CDS") executed by a member (regardless of the type of account in which the transaction is booked), including those in which the offsetting matching hedging transactions ("matching transactions") are effected by the member in CDS contracts that are cleared through the central counterparty clearing services of the Chicago Mercantile Exchange ("CME"). The proposed rule would expire on September 25, 2009.

A. Background

Recently, the Commission enacted interim final temporary rules (the "interim final temporary rules") providing enumerated exemptions under the federal securities laws for certain CDS to facilitate the operation of one or more central clearing counterparties in such CDS.[2] The Commission noted that this measure was intended to

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[2] See Securities Act Release No. 8999 (January 14, 2009), 74 FR 3967 (January 22, 2009) (Temporary Exemptions for Eligible Credit Default Swaps To Facilitate Operation of Central Counterparties To Clear and Settle Credit Default Swaps). Generally, as noted by the Commission, a CDS is a bilateral contract between two parties, known as counterparties. The value of this contract is based on underlying obligations of a single entity or on a particular security or other debt obligation, or an index of several such entities, securities, or obligations. The obligation of a seller to make payments under a CDS contract is triggered by a

address concerns arising from systemic risk posed by CDS, including, among others, risks to the financial system arising from the lack of a central clearing counterparty to clear and settle CDS.[3]

Historically, in the absence of a central clearing counterparty, CDS transactions entered into by U.S. investment banks have not been booked in the member, but rather in the affiliated entities. In light of the rapid growth of the CDS market, and the potential inability of parties to meet their obligations as counterparties, the lack of a central clearing counterparty poses risks not only to the two parties to a CDS transaction, but also to the financial system overall because of the resulting chain of significant economic loss when one or more parties default on their obligations under a CDS transaction. Accordingly, FINRA proposes to adopt Proposed FINRA Rule 4240, which would impose margin rules for certain CDS transactions. The Interim Pilot Program is intended to be coterminous with the Commission's interim final temporary rules and would expire on September 25, 2009.

FINRA requests comment on the proposed rule during the period of the Interim Pilot Program. Among other matters that commenters may wish to address, FINRA is particularly interested in the following questions:

1. Since historically CDS transactions have not been undertaken in broker-dealers and therefore have not exposed broker-dealers to the risks of such transactions, is the advent of broker-dealer participation in these transactions, which entails greater individual risks to broker-

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default or other credit event as to such entity or entities or such security or securities.

[3] See id.

dealers but which fosters less systemic risk because of the existence of a central clearing party for the matching transaction, a correct balancing of risks as a matter of public policy?

2. Do commenters believe that different or amended margin provisions would be superior to those set forth in the proposed rule?

B. Proposal

1. Scope of the Proposed Rule

Proposed FINRA Rule 4240(a) provides that the Interim Pilot Program would apply to margin requirements for any transactions in CDS executed by a member (regardless of the type of account in which the transaction is booked), including those in which the matching transactions are effected by the member in contracts that are cleared through the central clearing counterparty clearing services of the CME. FINRA notes that matching transactions that are cleared through the CME as the central clearing counterparty would be subject to margin requirements pursuant to CME rules (sometimes referred to in such rules as "performance bond"). Accordingly, with respect to these matching transactions, the proposed rule is intended to apply to the side of the CDS transaction – executed between a member and a customer or other broker-dealer[4] – that is *not* cleared through the CME.[5]

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4 NASD Rule 0120(g) states that the term "customer" shall not include a broker or dealer. For purposes of the proposed rule, the terms "customer or broker-dealer" and "customer and broker-dealer" are intended to include any party with which a member executes a CDS transaction.

5 Under Proposed FINRA Rule 4240(c)(1), such transactions are defined as "CME matching customer-side transactions." See Section B.3 under this Item. Note, as is clear from the context of the language in Proposed FINRA Rule 4240(c)(1), the term "CME matching customer-side transaction" includes any party, including a broker-dealer.

Proposed FINRA Rule 4240(a) would define the term "CDS" for purposes of the rule. Specifically, CDS would include any "eligible credit default swap" as defined in Securities Act Rule 239T(d),[6] as well as any other CDS that would otherwise meet such definition but for being subject to individual negotiation.[7] In addition, the proposed rule provides that, for purposes of the rule, the term "transaction" includes any ongoing CDS position.

Proposed FINRA Rule 4240(a) provides that the Interim Pilot Program would automatically expire on September 25, 2009.

2. Central Counterparty Clearing Arrangements

Proposed FINRA Rule 4240(b) would provide that any member, prior to establishing any clearing arrangement with respect to CDS transactions that makes use of any central counterparty clearing services provided by any clearing agency, pursuant to Securities Act Rule 239T(a)(1),[8] must notify FINRA in advance in writing, in such manner as may be specified by FINRA in a Regulatory Notice.

3. Margin Requirements: CDS Cleared on the CME

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6 17 CFR 230.239T(d).

7 FINRA notes that, because Rule 239T(d) excludes contracts that are "subject to individual negotiation," the proposed FINRA rule would reach CDS contracts, subject to the other criteria set forth in Rule 239T(d), without regard to whether they are individually negotiated. (Under Section 206A of the Gramm-Leach-Bliley Act, CDS fall within the meaning of the term "swap agreement," which Section 206A defines to mean, in part, "any agreement, contract, or transaction between eligible contract participants (as defined in Section 1(a)(12) of the Commodity Exchange Act . . .) . . . the material terms of which (other than price and quantity) are subject to individual negotiation . . ." As noted by the Commission, the Gramm-Leach-Bliley Act imposes certain limitations on the Commission's authority with respect to swap agreements. See 74 FR 3969.)

8 17 CFR 230.239T(a)(1).

Proposed FINRA Rule 4240(c)(1) provides that a member, as a minimum for computing customer or broker-dealer margin, with respect to any customer or broker-dealer transaction in CDS with a member in which the member executes a matching transaction that makes use of the central counterparty clearing facilities of the CME ("CME matching customer-side transaction"), must require the applicable margin pursuant to CME rules regardless of the type of account in which the transaction in CDS is booked. The proposed rule would require that members must, based on the risk monitoring procedures and guidelines set forth in paragraph (d) of the proposed rule,[9] determine whether the applicable CME requirements are adequate with respect to their customer and broker-dealer accounts and the positions in those accounts and, where appropriate, increase such margin in excess of the minimum margin. For this purpose, the proposed rule would permit members to use the margin requirements set forth in the proposed rule's Supplementary Material.[10]

It is FINRA's understanding that, after calculating margin on an account-specific basis, CME performs stress tests to assess concentration risk across a member's customer and house portfolios.[11] Further, CME may require that a member post additional margin based on the results of those concentration risk stress tests. Accordingly, Proposed FINRA Rule 4240(c)(1) would require that the aggregate amount of margin the member collects from customers and broker-dealers for transactions in CDS must equal or exceed

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9 See Proposed FINRA Rule 4240(d) in Exhibit 5 of this filing.

10 See Proposed FINRA Rule 4240.01 in Exhibit 5 of this filing.

11 See Letter from Lisa A. Dunsky, Director & Associate General Counsel, CME Group, to David Stawick, Secretary, Commodity Futures Trading Commission, dated December 19, 2008, available at: <http://www.cftc.gov>.

the aggregate amount of margin the member is required to post at CME with respect to those customer and broker-dealer transactions.

CME matching customer-side transactions, being subject to the margin guidelines set forth in Proposed FINRA Rule 4240(c)(1), are not subject to the margin guidelines as set forth in paragraph (c)(2) of the proposed rule. However, members are encouraged to apply higher margin requirements where appropriate.

4. Margin Requirements: CDS That Are Cleared on Central Counterparty Clearing Facilities Other Than the CME or That Settle Over-the-Counter ("OTC")

Proposed FINRA Rule 4240(c)(2) would provide that a member, with respect to any transaction in CDS that makes use of central counterparty clearing facilities other than the CME or that settle OTC, must require the applicable minimum margin as set forth in the proposed rule's Supplementary Material regardless of the type of account in which the transaction in CDS is booked.[12] However, the proposed rule provides that a member must, based on the risk monitoring procedures and guidelines set forth in paragraph (d) of the proposed rule, determine whether such margin is adequate with respect to their customer and broker-dealer accounts and, where appropriate, increase the requirements.

5. Risk Monitoring Procedures and Guidelines

Proposed FINRA Rule 4240(d) provides that members must monitor the risk of any customer or broker-dealer accounts with exposure to CDS and must maintain a comprehensive written risk analysis methodology for assessing the potential risk to the

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[12] See Proposed FINRA Rule 4240.01 in Exhibit 5 of this filing.

member's capital over a specified range of possible market movements over a specified time period. The proposed rule would require that members must employ the risk monitoring procedures and guidelines set forth in Proposed FINRA Rule 4240(d)(1) through (8).[13] Further, the rule would require the member to review, in accordance with the member's written procedures, at reasonable periodic intervals, the member's credit extension activities for consistency with the risk monitoring procedures and guidelines set forth in the rule, and to determine whether the data necessary to apply the risk monitoring procedures and guidelines is accessible on a timely basis and information systems are available to adequately capture, monitor, analyze and report relevant data (i.e., the data relevant for purposes of the risk monitoring procedures and guidelines set forth in Proposed FINRA Rule 4240(d)(1) through (8)).

6. Concentrations

Proposed FINRA Rule 4240(e) would require that, where the maximum current and potential exposure with respect to the largest single name CDS across all accounts exceeds the member's tentative net capital, the member must take a capital charge equal to the aggregate margin requirement for such accounts on the positions in such single name CDS in accordance with the tables set forth in the proposed rule's Supplementary Material.[14] This additional requirement for concentrated positions reflects FINRA's concern for the possibility of a sudden default in the largest single name CDS across all accounts in respect of which a member has current or potential exposure. However, the

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13 See Proposed FINRA Rule 4240(d)(1) through (8) in Exhibit 5 of this filing.

14 See Proposed FINRA Rule 4240.01 in Exhibit 5 of this filing.

proposed rule would allow a member to reduce this capital charge by the amount of the excess margin held in all customer and broker-dealer accounts.

7. Proposed FINRA Rule 4240.01

Proposed FINRA Rule 4240.01, a Supplementary Material, sets forth the customer and broker-dealer margin requirements that would apply with respect to CDS, as appropriate, pursuant to paragraph (c) of the proposed rule. The proposed rule addresses customer and broker-dealer accounts that are short a CDS, accounts that are long a CDS and accounts that maintain both long and short CDS. Paragraph (c) of the Supplementary Material provides, with respect to accounts that maintain both long and short CDS, that if a customer or broker-dealer is long the bond and long a CDS contract on the same underlying obligor, margin would need to be collected only on the long bond position, provided that bond can be delivered against the short CDS contract, as prescribed pursuant to applicable FINRA margin rules. In instances where the customer or broker-dealer is short the bond and short the CDS, margin need only be collected on the short bond, again as prescribed pursuant to applicable FINRA margin rules. FINRA notes that, for purposes of the proposed rule, the term "applicable FINRA margin rules" refers to requirements pursuant to NASD Rule 2520 or Incorporated NYSE Rule 431, as applicable to the member.[15] FINRA plans to address NASD Rule 2520 and Incorporated NYSE Rule 431 later as part of FINRA's rulebook consolidation process, and,

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15 The current FINRA rulebook consists of: (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE ("Incorporated NYSE Rules"). While the NASD Rules generally apply to all FINRA members, 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 members, unless such rules have a more limited application by their terms.

accordingly, will amend Proposed FINRA Rule 4240.01(c) as appropriate to refer to the new, consolidated FINRA margin rule.[16]

As noted in Item 2 of this filing, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval, but FINRA does intend to issue such Regulatory Notice as soon as practicable in the event of SEC approval of the proposed rule change given the limited time period of the proposed Interim Pilot Program.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[17] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change would further the purposes of the Act because, consistent with goals set forth by the Commission when it adopted the interim final temporary rules with respect to the operation of central counterparties to clear and settle CDS, the margin requirements set forth by the proposed rule change will help to stabilize the financial markets.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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16 For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process).

17 15 U.S.C. 78o–3(b)(6).

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.[18]

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

FINRA requests the Commission to find good cause pursuant to Section 19(b)(2) of the Act[19] for approving the proposed rule change prior to the 30th day after its publication in the Federal Register.

Because FINRA believes that, consistent with the goals announced by the Commission when it adopted the interim final temporary rules with respect to the operation of central counterparties to clear and settle CDS, the margin requirements set forth by the proposed rule change will help to stabilize the financial markets, FINRA requests the Commission to accelerate the effectiveness of the proposed rule change prior to the 30th day after its publication in the Federal Register.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

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18 15 U.S.C. 78s(b)(2).

19 15 U.S.C. 78s(b)(2).

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 5. Text of proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2009-012)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to Margin Requirements for Certain Transactions in Credit Default Swaps

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on , Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt FINRA Rule 4240 (Margin Requirements for Credit Default Swaps). The proposed rule would implement an interim pilot program with respect to margin requirements for transactions in credit default swaps executed by a member (regardless of the type of account in which the transaction is booked), including those in which the offsetting matching hedging transactions are effected by the member in credit default swap contracts that are cleared through the central counterparty clearing

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

services of the Chicago Mercantile Exchange. The proposed rule would expire on September 25, 2009.

The text of the proposed rule change is available on FINRA's Web site at http://www.finra.org, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

FINRA is proposing to adopt FINRA Rule 4240 (Margin Requirements for Credit Default Swaps). The proposed rule would implement an interim pilot program (the "Interim Pilot Program") with respect to margin requirements for transactions in credit default swaps ("CDS") executed by a member (regardless of the type of account in which the transaction is booked), including those in which the offsetting matching hedging transactions ("matching transactions") are effected by the member in CDS contracts that are cleared through the central counterparty clearing services of the Chicago Mercantile Exchange ("CME"). The proposed rule would expire on September 25, 2009.

(A) Background

Recently, the Commission enacted interim final temporary rules (the "interim final temporary rules") providing enumerated exemptions under the federal securities laws for certain CDS to facilitate the operation of one or more central clearing counterparties in such CDS.[3] The Commission noted that this measure was intended to address concerns arising from systemic risk posed by CDS, including, among others, risks to the financial system arising from the lack of a central clearing counterparty to clear and settle CDS.[4]

Historically, in the absence of a central clearing counterparty, CDS transactions entered into by U.S. investment banks have not been booked in the member, but rather in the affiliated entities. In light of the rapid growth of the CDS market, and the potential inability of parties to meet their obligations as counterparties, the lack of a central clearing counterparty poses risks not only to the two parties to a CDS transaction, but also to the financial system overall because of the resulting chain of significant economic loss when one or more parties default on their obligations under a CDS transaction. Accordingly, FINRA proposes to adopt Proposed FINRA Rule 4240, which would impose margin rules for certain CDS transactions. The Interim Pilot Program is intended

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3 See Securities Act Release No. 8999 (January 14, 2009), 74 FR 3967 (January 22, 2009) (Temporary Exemptions for Eligible Credit Default Swaps To Facilitate Operation of Central Counterparties To Clear and Settle Credit Default Swaps). Generally, as noted by the Commission, a CDS is a bilateral contract between two parties, known as counterparties. The value of this contract is based on underlying obligations of a single entity or on a particular security or other debt obligation, or an index of several such entities, securities, or obligations. The obligation of a seller to make payments under a CDS contract is triggered by a default or other credit event as to such entity or entities or such security or securities.

4 See id.

to be coterminous with the Commission's interim final temporary rules and would expire on September 25, 2009.

FINRA requests comment on the proposed rule during the period of the Interim Pilot Program. Among other matters that commenters may wish to address, FINRA is particularly interested in the following questions:

1. Since historically CDS transactions have not been undertaken in broker-dealers and therefore have not exposed broker-dealers to the risks of such transactions, is the advent of broker-dealer participation in these transactions, which entails greater individual risks to broker-dealers but which fosters less systemic risk because of the existence of a central clearing party for the matching transaction, a correct balancing of risks as a matter of public policy?
2. Do commenters believe that different or amended margin provisions would be superior to those set forth in the proposed rule?

(B) Proposal

(1) Scope of the Proposed Rule

Proposed FINRA Rule 4240(a) provides that the Interim Pilot Program would apply to margin requirements for any transactions in CDS executed by a member (regardless of the type of account in which the transaction is booked), including those in which the matching transactions are effected by the member in contracts that are cleared through the central clearing counterparty clearing services of the CME. FINRA notes that matching transactions that are cleared through the CME as the central clearing counterparty would be subject to margin requirements pursuant to CME rules (sometimes

referred to in such rules as "performance bond"). Accordingly, with respect to these matching transactions, the proposed rule is intended to apply to the side of the CDS transaction – executed between a member and a customer or other broker-dealer[5] – that is *not* cleared through the CME.[6]

Proposed FINRA Rule 4240(a) would define the term "CDS" for purposes of the rule. Specifically, CDS would include any "eligible credit default swap" as defined in Securities Act Rule 239T(d),[7] as well as any other CDS that would otherwise meet such definition but for being subject to individual negotiation.[8] In addition, the proposed rule provides that, for purposes of the rule, the term "transaction" includes any ongoing CDS position.

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5 NASD Rule 0120(g) states that the term "customer" shall not include a broker or dealer. For purposes of the proposed rule, the terms "customer or broker-dealer" and "customer and broker-dealer" are intended to include any party with which a member executes a CDS transaction.

6 Under Proposed FINRA Rule 4240(c)(1), such transactions are defined as "CME matching customer-side transactions." See Section (B)(3) under this Item. Note, as is clear from the context of the language in Proposed FINRA Rule 4240(c)(1), the term "CME matching customer-side transaction" includes any party, including a broker-dealer.

7 17 CFR 230.239T(d).

8 FINRA notes that, because Rule 239T(d) excludes contracts that are "subject to individual negotiation," the proposed FINRA rule would reach CDS contracts, subject to the other criteria set forth in Rule 239T(d), without regard to whether they are individually negotiated. (Under Section 206A of the Gramm-Leach-Bliley Act, CDS fall within the meaning of the term "swap agreement," which Section 206A defines to mean, in part, "any agreement, contract, or transaction between eligible contract participants (as defined in Section 1(a)(12) of the Commodity Exchange Act . . .) . . . the material terms of which (other than price and quantity) are subject to individual negotiation . . ." As noted by the Commission, the Gramm-Leach-Bliley Act imposes certain limitations on the Commission's authority with respect to swap agreements. See 74 FR 3969.)

Proposed FINRA Rule 4240(a) provides that the Interim Pilot Program would automatically expire on September 25, 2009.

(2) Central Counterparty Clearing Arrangements

Proposed FINRA Rule 4240(b) would provide that any member, prior to establishing any clearing arrangement with respect to CDS transactions that makes use of any central counterparty clearing services provided by any clearing agency, pursuant to Securities Act Rule 239T(a)(1),[9] must notify FINRA in advance in writing, in such manner as may be specified by FINRA in a Regulatory Notice.

(3) Margin Requirements: CDS Cleared on the CME

Proposed FINRA Rule 4240(c)(1) provides that a member, as a minimum for computing customer or broker-dealer margin, with respect to any customer or broker-dealer transaction in CDS with a member in which the member executes a matching transaction that makes use of the central counterparty clearing facilities of the CME ("CME matching customer-side transaction"), must require the applicable margin pursuant to CME rules regardless of the type of account in which the transaction in CDS is booked. The proposed rule would require that members must, based on the risk monitoring procedures and guidelines set forth in paragraph (d) of the proposed rule,[10] determine whether the applicable CME requirements are adequate with respect to their customer and broker-dealer accounts and the positions in those accounts and, where appropriate, increase such margin in excess of the minimum margin. For this purpose,

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9 17 CFR 230.239T(a)(1).

10 See Proposed FINRA Rule 4240(d) in Exhibit 5 of this filing.

the proposed rule would permit members to use the margin requirements set forth in the proposed rule's Supplementary Material.[11]

It is FINRA's understanding that, after calculating margin on an account-specific basis, CME performs stress tests to assess concentration risk across a member's customer and house portfolios.[12] Further, CME may require that a member post additional margin based on the results of those concentration risk stress tests. Accordingly, Proposed FINRA Rule 4240(c)(1) would require that the aggregate amount of margin the member collects from customers and broker-dealers for transactions in CDS must equal or exceed the aggregate amount of margin the member is required to post at CME with respect to those customer and broker-dealer transactions.

CME matching customer-side transactions, being subject to the margin guidelines set forth in Proposed FINRA Rule 4240(c)(1), are not subject to the margin guidelines as set forth in paragraph (c)(2) of the proposed rule. However, members are encouraged to apply higher margin requirements where appropriate.

(4) Margin Requirements: CDS That Are Cleared on Central Counterparty Clearing Facilities Other Than the CME or That Settle Over-the-Counter ("OTC")

Proposed FINRA Rule 4240(c)(2) would provide that a member, with respect to any transaction in CDS that makes use of central counterparty clearing facilities other than the CME or that settle OTC, must require the applicable minimum margin as set

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11 See Proposed FINRA Rule 4240.01 in Exhibit 5 of this filing.

12 See Letter from Lisa A. Dunsky, Director & Associate General Counsel, CME Group, to David Stawick, Secretary, Commodity Futures Trading Commission, dated December 19, 2008, available at: <http://www.cftc.gov>.

forth in the proposed rule's Supplementary Material regardless of the type of account in which the transaction in CDS is booked.[13] However, the proposed rule provides that a member must, based on the risk monitoring procedures and guidelines set forth in paragraph (d) of the proposed rule, determine whether such margin is adequate with respect to their customer and broker-dealer accounts and, where appropriate, increase the requirements.

(5) Risk Monitoring Procedures and Guidelines

Proposed FINRA Rule 4240(d) provides that members must monitor the risk of any customer or broker-dealer accounts with exposure to CDS and must maintain a comprehensive written risk analysis methodology for assessing the potential risk to the member's capital over a specified range of possible market movements over a specified time period. The proposed rule would require that members must employ the risk monitoring procedures and guidelines set forth in Proposed FINRA Rule 4240(d)(1) through (8).[14] Further, the rule would require the member to review, in accordance with the member's written procedures, at reasonable periodic intervals, the member's credit extension activities for consistency with the risk monitoring procedures and guidelines set forth in the rule, and to determine whether the data necessary to apply the risk monitoring procedures and guidelines is accessible on a timely basis and information systems are available to adequately capture, monitor, analyze and report relevant data (i.e., the data relevant for purposes of the risk monitoring procedures and guidelines set forth in Proposed FINRA Rule 4240(d)(1) through (8)).

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13 See Proposed FINRA Rule 4240.01 in Exhibit 5 of this filing.

14 See Proposed FINRA Rule 4240(d)(1) through (8) in Exhibit 5 of this filing.

(6) Concentrations

Proposed FINRA Rule 4240(e) would require that, where the maximum current and potential exposure with respect to the largest single name CDS across all accounts exceeds the member's tentative net capital, the member must take a capital charge equal to the aggregate margin requirement for such accounts on the positions in such single name CDS in accordance with the tables set forth in the proposed rule's Supplementary Material.[15] This additional requirement for concentrated positions reflects FINRA's concern for the possibility of a sudden default in the largest single name CDS across all accounts in respect of which a member has current or potential exposure. However, the proposed rule would allow a member to reduce this capital charge by the amount of the excess margin held in all customer and broker-dealer accounts.

(7) Proposed FINRA Rule 4240.01

Proposed FINRA Rule 4240.01, a Supplementary Material, sets forth the customer and broker-dealer margin requirements that would apply with respect to CDS, as appropriate, pursuant to paragraph (c) of the proposed rule. The proposed rule addresses customer and broker-dealer accounts that are short a CDS, accounts that are long a CDS and accounts that maintain both long and short CDS. Paragraph (c) of the Supplementary Material provides, with respect to accounts that maintain both long and short CDS, that if a customer or broker-dealer is long the bond and long a CDS contract on the same underlying obligor, margin would need to be collected only on the long bond position, provided that bond can be delivered against the short CDS contract, as prescribed pursuant to applicable FINRA margin rules. In instances where the customer

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15 See Proposed FINRA Rule 4240.01 in Exhibit 5 of this filing.

or broker-dealer is short the bond and short the CDS, margin need only be collected on the short bond, again as prescribed pursuant to applicable FINRA margin rules. FINRA notes that, for purposes of the proposed rule, the term "applicable FINRA margin rules" refers to requirements pursuant to NASD Rule 2520 or Incorporated NYSE Rule 431, as applicable to the member.[16] FINRA plans to address NASD Rule 2520 and Incorporated NYSE Rule 431 later as part of FINRA's rulebook consolidation process, and, accordingly, will amend Proposed FINRA Rule 4240.01(c) as appropriate to refer to the new, consolidated FINRA margin rule.[17]

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval, but FINRA does intend to issue such Regulatory Notice as soon as practicable in the event of SEC approval of the proposed rule change given the limited time period of the proposed Interim Pilot Program.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[18] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote

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16 The current FINRA rulebook consists of: (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE ("Incorporated NYSE Rules"). While the NASD Rules generally apply to all FINRA members, 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 members, unless such rules have a more limited application by their terms.

17 For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process).

18 15 U.S.C. 78o–3(b)(6).

just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change would further the purposes of the Act because, consistent with goals set forth by the Commission when it adopted the interim final temporary rules with respect to the operation of central counterparties to clear and settle CDS, the margin requirements set forth by the proposed rule change will help to stabilize the financial markets.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

FINRA has requested that the Commission find good cause pursuant to Section 19(b)(2) of the Act[19] for approving the proposed rule change prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to FINRA and, in particular, the requirements of Section 15A of the Act and the rules and regulations thereunder. The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in that accelerated approval will, consistent with the goals announced by the

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19 15 U.S.C. 78s(b)(2).

Commission when it adopted the interim final temporary rules with respect to the operation of central counterparties to clear and settle CDS, help to stabilize the financial markets by setting forth margin requirements for certain transactions in CDS.

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2009-012 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Florence E. Harmon, Deputy Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2009-012. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2009-012 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[20]

Florence E. Harmon

Deputy Secretary

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[20] 17 CFR 200.30-3(a)(12).

EXHIBIT 5

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; deletions are in brackets.

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Text of Proposed New FINRA Rule 4240

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4000. FINANCIAL AND OPERATIONAL RULES

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4200. MARGIN

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4240. Margin Requirements for Credit Default Swaps

(a) Effective Period of Interim Pilot Program

This Rule establishes an interim pilot program ("Interim Pilot Program") with respect to margin requirements for any transactions in credit default swaps executed by a member (regardless of the type of account in which the transaction is booked), including those in which the offsetting matching hedging transactions ("matching transactions") are effected by the member in contracts that are cleared through the central counterparty clearing services of the Chicago Mercantile Exchange ("CME"). The Interim Pilot Program shall automatically expire on September 25, 2009. For purposes of this Rule, the term "credit default swap" ("CDS") shall mean any "eligible credit default swap" as defined in Securities Act Rule 239T(d), as well as any other CDS that would otherwise meet such definition but for being subject to individual negotiation, and the term "transaction" shall include any ongoing CDS position.

(b) Central Counterparty Clearing Arrangements

Any member, prior to establishing any clearing arrangement with respect to CDS transactions that makes use of any central counterparty clearing services provided by any clearing agency, pursuant to Securities Act Rule 239T(a)(1), must notify FINRA in advance in writing, in such manner as may be specified by FINRA in a Regulatory Notice.

(c) Margin Requirements

(1) CDS Cleared on the Chicago Mercantile Exchange

Members shall require as a minimum for computing customer or broker-dealer margin, with respect to any customer or broker-dealer transaction in CDS with a member in which the member executes a matching transaction that makes use of the central counterparty clearing facilities of the CME ("CME matching customer-side transaction"), the applicable margin pursuant to CME rules (sometimes referred to in such rules as a "performance bond") regardless of the type of account in which the transaction in CDS is booked. Members shall, based on the risk monitoring procedures and guidelines set forth in paragraph (d) of this Rule, determine whether the applicable CME requirements are adequate with respect to their customer and broker-dealer accounts and the positions in those accounts and, where appropriate, increase such margin in excess of such minimum margin. For this purpose, members are permitted to use the margin requirements set forth in Supplementary Material .01 of this Rule.

The aggregate amount of margin the member collects from customers and broker-dealers for transactions in CDS must equal or exceed the aggregate amount of margin the member is required to post at CME with respect to those customer and broker-dealer transactions.

CME matching customer-side transactions are not subject to the provisions of paragraph (c)(2) of this Rule.

(2) CDS That Are Cleared on Central Counterparty Clearing Facilities Other Than the CME or That Settle Over-the-Counter ("OTC")

Members shall require, with respect to any transaction in CDS that makes use of central counterparty clearing facilities other than the CME or that settle OTC, the applicable minimum margin as set forth in Supplementary Material .01 of this Rule regardless of the type of account in which the transaction in CDS is booked. However, members shall, based on the risk monitoring procedures and guidelines set forth in paragraph (d) of this Rule, determine whether such margin is adequate with respect to their customer and broker-dealer accounts and, where appropriate, increase such requirements.

(d) Risk Monitoring Procedures and Guidelines

Members shall monitor the risk of any customer or broker-dealer accounts with exposure to CDS and shall maintain a comprehensive written risk analysis methodology for assessing the potential risk to the member's capital over a specified range of possible market movements over a specified time period. For purposes of this Rule, members must employ the risk monitoring procedures and guidelines set forth in paragraphs (d)(1) through (8) of this Rule. The member must review, in accordance with the member's written procedures, at reasonable periodic intervals, the member's credit extension activities for consistency with the risk monitoring procedures and guidelines set forth in this Rule, and must determine whether the data necessary to apply the risk monitoring

procedures and guidelines is accessible on a timely basis and information systems are available to adequately capture, monitor, analyze and report relevant data, including:

(1) obtaining and reviewing the required account documentation and financial information necessary for assessing the amount of credit to be extended to customers and broker-dealers;

(2) assessing the determination, review and approval of credit limits to each customer and broker-dealer, and across all customers and broker-dealers, engaging in CDS transactions;

(3) monitoring credit risk exposure to the member from CDS, including the type, scope and frequency of reporting to senior management;

(4) the use of stress testing of accounts containing CDS contracts in order to monitor market risk exposure from individual accounts and in the aggregate;

(5) managing the impact of credit extended related to CDS contracts on the member's overall risk exposure;

(6) determining the need to collect additional margin from a particular customer or broker-dealer, including whether that determination was based upon the creditworthiness of the customer or broker-dealer and/or the risk of the specific contracts;

(7) monitoring the credit exposure resulting from concentrated positions within both individual accounts and across all accounts containing CDS contracts; and

(8) maintaining sufficient margin in each customer and broker-dealer account to protect against the default of the largest individual exposure in the account as measured by computing the largest maximum possible loss.

(e) Concentrations

Where the maximum current and potential exposure with respect to the largest single name CDS across all accounts exceeds the member's tentative net capital, the member must take a capital charge equal to the aggregate margin requirement for such accounts on the positions in such single name CDS in accordance with the tables set forth in Supplementary Material .01 of this Rule. This capital charge may be reduced by the amount of excess margin held in all customer and broker-dealer accounts.

• • • Supplementary Material: ----------

.01 Margin Requirements for CDS. The following customer and broker-dealer margin requirements shall apply, as appropriate, pursuant to paragraph (c) of this Rule.

(a) Customer and Broker-Dealer Accounts That Are Short a CDS

The following table shall be used to determine the margin that a member must collect from a customer or broker-dealer that is short a single name debt security CDS contract (sold protection). The margin is to be collected based upon the basis point spread over LIBOR of the CDS contract as well as the maturity of that contract as a percentage of the notional amount, shall be as follows:

Basis Point Spread	**Length of Time to Maturity of CDS Contract**			
	1 year	**3 years**	**5 years**	**7 years & longer**
0-100	1%	2%	4%	7%
100-300	2%	5%	7%	10%
300-500	5%	10%	15%	20%

500-700	10%	15%	20%	25%
700 and above	15%	20%	25%	30%

For those CDS contracts where the underlying obligation is a debt index, rather than a single name bond, the margin requirement as a percentage of the notional amount shall be as follows:

	Length of Time to Maturity of CDS Contract				
Index	**1 year**	**3 years**	**5 years**	**7 years**	**10 years**
CDX.IG	1%	1%	2%	4%	5%
CDX.HY	3%	5%	10%	12%	15%
CDX.HVOL	2%	3%	4%	5%	7%

(b) Accounts That Are Long a CDS

For customer or broker-dealer accounts that are long the CDS contracts (purchased protection), the margin to be collected shall be 50% of the above amounts.

(c) Accounts That Maintain Both Long and Short CDS

In instances where the customer or broker-dealer maintains both long and short CDS, the member may elect to collect 50% of the above margin requirements on the greater of the long or short position within the same Bloomberg CDS sector, provided those long and short positions are in the same spread and maturity bucket.

If a customer or broker-dealer is long the bond and long a CDS contract on the same underlying obligor, margin needs to be collected only on the long bond position, provided that bond can be delivered against the short CDS contract, as prescribed pursuant to applicable FINRA margin rules.

In instances where the customer or broker-dealer is short the bond and short the CDS, margin need only be collected on the short bond, as prescribed pursuant to applicable FINRA margin rules.

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