# Notices

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## 12-52

### Front Running

### **SEC Approves Consolidated Front Running Rule**

Effective Date: June 1, 2013

### **Executive Summary**

Effective June 1, 2013, FINRA Rule 5270 addressing the front running of block transactions will replace NASD IM-2110-3 in the Consolidated FINRA Rulebook.¹ Among other changes, Rule 5270 applies to a broader range of securities than IM-2110-3, includes new Supplementary Material regarding permitted transactions, and codifies that front running of a customer order may violate other FINRA rules or the federal securities laws.

The text of the new rule is available in the online FINRA Manual.

Questions concerning this *Notice* should be directed to Brant K. Brown, Associate General Counsel, Office of General Counsel at (202) 728-6927.

### Background & Discussion

On September 4, 2012, the SEC approved FINRA's proposal to adopt NASD IM-2110-3, with the changes discussed below, as FINRA Rule 5270 in the Consolidated FINRA Rulebook.<sup>2</sup> Rule 5270 provides that no member or person associated with a member shall cause to be executed an order to buy or sell a security or a related financial instrument when the member or person associated with the member causing the order to be executed has material, non-public market information<sup>3</sup> concerning an imminent block transaction<sup>4</sup> in that security, a related financial instrument or a security underlying the related financial instrument prior to the time information concerning the block transaction has been made publicly available or has otherwise become stale or obsolete.<sup>5</sup> The rule applies to orders caused to be executed for (1) any account in which the member or person associated with the member has an interest, (2) any account with respect to which the member or person associated with the member exercises investment discretion, and (3) any account of customers or affiliates of the member when the customer or affiliate has been provided such material, non-public market information by the member or any person associated with the member.<sup>6</sup>

### December 2012

### **Notice Type**

- ► Consolidated Rulebook
- ► New Rule

### **Suggested Routing**

- ► Compliance
- ► Legal
- ▶ Operations
- ► Senior Management
- ➤ Systems
- ▶ Trading

### **Key Topics**

- ► Customer Order Protection
- ► Front Running

### Referenced Rules & Notices

- ► FINRA Rule 0150
- ► FINRA Rule 2010
- ► FINRA Rule 5270
- ► FINRA Rule 5320
- ► FINRA Rule 6730
- ► NASD IM-2110-3
- ► NTM 05-51
- ► NTM 97-57
- ► NTM 96-66
- ► NTM 87-69
- ► Regulatory Notice 10-24



Rule 5270 differs from IM-2110-3 in several important ways. First, the trading restrictions in Rule 5270 apply to a broader range of securities than IM-2110-3. Second, Rule 5270 includes new Supplementary Material .04 regarding permitted transactions that replaces the exceptions in IM-2110-3. Finally, new Supplementary Material .05 codifies that the front running of any customer order, not just imminent block transactions, that places the financial interests of the firm ahead of those of its customer or the misuse of knowledge of an imminent customer order may violate other FINRA rules, including FINRA Rules 2010 and 5320, or the federal securities laws. Each of these changes is discussed below.

### **Expansion of Transactions**

The front running prohibitions in Rule 5270 address trading in significantly more types of securities than IM-2110-3.8 Rule 5270 covers trading in an option, derivative or other financial instrument overlying a security that is the subject of an imminent block transaction if the value of the underlying security is materially related to, or otherwise acts as a substitute for, such security, as well as any contract that is the functional economic equivalent of a position in such security (individually or collectively a "related financial instrument").9 The reverse is also true: When the imminent block transaction involves a related financial instrument, Rule 5270 prohibits trading in the underlying security. Rule 5270 also applies to trading in the same security or related financial instrument that is the subject of an imminent block transaction.

Like IM-2110-3, the trading restrictions imposed by Rule 5270 generally apply until information about the imminent customer block transaction "has been made publicly available," which the rule defines as having been disseminated to the public in trade reporting data. However, because Rule 5270 includes related financial instruments that may not result in publicly available trading information being made available, the prohibitions in the rule are in place until the material, non-public market information is either publicly available or "otherwise becomes stale or obsolete." <sup>11</sup>

#### **Permitted Transactions**

Supplementary Material .04 sets forth three broad categories of permitted transactions: (1) transactions that a firm can demonstrate are unrelated to the customer block order, (2) transactions that are undertaken to fulfill or facilitate the execution of the customer block order, and (3) transactions that are executed, in whole or in part, on a national securities exchange and comply with the marketplace rules of that exchange.<sup>12</sup>

Supplementary Material .04(a) permits transactions that a firm can demonstrate are unrelated to the material, non-public market information received in connection with the customer block order. The Supplementary Material provides examples of transactions that,

depending upon the circumstances, may be considered to be unrelated to the customer block order and, therefore, permitted under the rule. These transactions could include transactions where the firm has effective information barriers established to prevent internal disclosure of customer order information, <sup>13</sup> transactions in the security that is the subject of the customer block order that are related to a prior customer order in that security, transactions to correct bona fide errors and transactions to offset odd-lot orders. For each of these types of transactions, the firm must be able to demonstrate that the transaction at issue was unrelated to the customer block order. Thus, for example, if the firm can demonstrate that transactions occurring in a security (or a related financial instrument) that is the subject of an imminent customer block order were undertaken by a desk that is walled off from the desk handling the customer block order by the use of effective information barriers, the trading activity would be unrelated to the customer block order and would not violate the rule. <sup>14</sup>

The second category of permitted transactions involves transactions that are undertaken to fulfill or facilitate the execution of the customer block order. FINRA has acknowledged that firms are permitted to trade ahead of a customer's block order when the purpose of the trading is to fulfill the customer order and when the customer has authorized the trading, including that the firm has disclosed to the customer that it may trade ahead of, or alongside, the customer's order. Supplementary Material .04(b) states that Rule 5270 does not preclude transactions undertaken for the purpose of fulfilling, or facilitating the execution of, a customer's block order. However, when engaging in trading activity that could affect the market for the security that is the subject of the customer block order, the firm must minimize any potential disadvantage or harm in the execution of the customer's order, must not place the firm's financial interests ahead of those of its customer and must obtain the customer's consent to the trading activity.

The third, and final, category of permitted transactions is addressed in Supplementary Material .04(c) and concerns transactions that are executed, in whole or in part, on a national securities exchange and comply with the marketplace rules of that exchange. This provision states that the prohibitions in Rule 5270 shall not apply if the firm's trading activity is undertaken in compliance with the marketplace rules of a national securities exchange and at least one leg of the trading activity is executed on that exchange.

#### **Other Rules**

Rule 5270 does not provide an exhaustive list of prohibited front running activity, and Supplementary Material .05 clarifies that the front running of other types of orders that may not be "imminent block transactions" may nonetheless be considered conduct inconsistent with just and equitable principles of trade and may violate other FINRA rules or provisions of the federal securities laws.<sup>18</sup>

### **Endnotes**

- See Securities Exchange Act Release No. 67774 (September 4, 2012), 77 FR 55519 (September 10, 2012) (Order Approving File No. SR-FINRA-2012-025). 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. For more information about the rulebook consolidation process, see Information Notice 03/12/08 (Rulebook Consolidation Process).
- Securities Exchange Act Release No. 67774 (September 4, 2012), 77 FR 55519 (September 10, 2012).
- The violative practices in Rule 5270 may include transactions that are executed based upon knowledge of less than all of the terms of the block transaction, so long as there is knowledge that all of the material terms of the transaction have been or will be agreed upon imminently. See Rule 5270.01. This provision, which remains substantively the same as the standard in IM-2110-3, is intended to make clear that a firm need not know every detail of a potential block order for the front running prohibitions to attach. FINRA has also provided similar guidance in the past in the context of volume-weighted average price transactions. See Notice to Members 05-51 (stating that a duty to refrain from trading may exist "before a member is awarded an order for execution [and] will turn on, among other factors, the type of order and the specifics of the order known by the member," which may include the security, the size of the order, the side of the market, the weighting of a basket order, and the timing for completion of the order). Exactly

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- when the front running prohibitions may attach depends upon the facts and circumstances of the communications between the firm and its customer.
- Supplementary Material .03 retains the general scope of the term block transaction from IM-2110-3. It provides that, for purposes of equity securities, a transaction involving 10,000 shares or more of a security, an underlying security, or a related financial instrument overlying such number of shares, is generally deemed to be a block transaction; however, a transaction of fewer than 10,000 shares could be considered a block transaction in some cases. Supplementary Material .03 also notes that a block transaction that has been agreed upon does not lose its identity as such by arranging for partial executions of the full transaction in portions which themselves are not of block size if the execution of the full transaction may have a material impact on the market.
- 5. The term "related financial instrument" is defined as any option, derivative, security-based swap or other financial instrument overlying a security, the value of which is materially related to, or otherwise acts as a substitute for, the security, as well as any contract that is the functional economic equivalent of a position in such security. See Rule 5270(c).
- 5. See Rule 5270(b).
- Although "not held" orders are not subject
  to the restrictions in FINRA Rule 5320, front
  running a "not held" order that is not of block
  size may nonetheless violate FINRA Rule
  2010. See Securities Exchange Act Release
  No. 63895 (February 11, 2011), 76 FR 9386
  (February 17, 2011) (Order Approving File No.
  SR-FINRA-2009-090). If the "not held" order is
  of block size, Rule 5270 would apply to trading
  activity ahead of the order.

- 8. IM-2110-3 is limited to transactions in equity securities and options that are required to be reported on a last sale reporting system and to any transaction involving a security future, regardless of whether the transaction is reported.
- FINRA Rule 5270 does not apply to orders or transactions involving government securities. FINRA Rule 0150(c) lists the rules applicable to transactions in, and business activity relating to, "exempted securities," which include government securities. Rule 5270 is not included in the list of rules applicable to transactions in, and business activities relating to, "exempted securities" and therefore does not apply to orders or transactions involving "exempted securities." The term "exempted securities" for purposes of Rule 0150 has the same meaning as that in Section 3(a)(12) of the Securities Exchange Act of 1934 ("Act"). See FINRA Rule 0150(a). Section 3(a)(12) of the Act defines "exempted security" or "exempted securities" to include, among other things, government securities. See 15 U.S.C. 78c(a)(12), (a)(42). FINRA notes, however, that actions for similar front running conduct occurring in the exempted securities markets, including the government securities market, continue to be covered by FINRA Rule 2010.
- 10. Supplementary Material .02 retains the analysis of when information is considered "publicly available" from IM-2110-3 and states that "[t]he requirement that information concerning a block transaction be made publicly available will not be satisfied until the entire block transaction has been completed and publicly reported."
- 11. Whether information has become "stale or obsolete" for purposes of Rule 5270 will depend upon the particular facts and circumstances involved, including specific information the member firm has regarding the transaction,
- but could include factors such as the amount of time that has passed since the member learned of the block transaction, subsequent trading activity in the security, or a significant change in market conditions. The "stale or obsolete" standard supplements the dissemination standard; it does not replace it. Consequently, where there is a transparency regime in place with respect to the security or financial instrument (i.e., transactions are subject to prompt reporting requirements and the transaction reports are disseminated) the trading restrictions in Rule 5270 are linked to actual reporting and dissemination rather than by invoking the "stale or obsolete" standard. This would include debt securities subject to TRACE reporting requirements, even though the TRACE reporting requirements generally allow for up to 15 minutes to report transactions in corporate and agency debt securities. See FINRA Rule 6730(a). FINRA notes that there should generally be minimal, or no, delay between the execution of an order and the reporting of the trade. See, e.g., Regulatory Notice 10-24 (April 2010). Where there is no reporting and dissemination regime in place for a security or related financial instrument, once the customer's order is executed and the risk of the transaction has transferred from the customer to the firm, there would be no trading restrictions imposed by Rule 5270.
- 12. Supplementary Material .04 replaces the provisions in IM-2110-3 excepting transactions executed in automatic execution systems and positioning activity when a firm receives an order of block size relating to both an option or security future and the underlying security. Any trading activity that fell within the exceptions in IM-2110-3 would need to meet one of the exceptions in Supplementary Material .04 to comply with Rule 5270.

- 13. In addition to more traditional information barriers, such as those in place to prevent communication between trading units, this provision could also include the use of automated systems (e.g., trades through a "black box") where the orders placed into the automated system are handled without the knowledge of a person associated with the member who may be trading in the same security. However, a person associated with a member who places an order into a "black box" or other automated system, or otherwise has knowledge of the order or the ability to access information in the system, may not then trade in the same security or a related financial instrument solely because the order ultimately was being handled by the automated system rather than by the person. Traders who have no knowledge of the order, due to the presence of an information barrier or otherwise, could continue to trade in the security or a related financial instrument. Automated systems may serve as a means by which orders are handled and information regarding those orders is unavailable to other trading units; however, the use of an automated system does not permit trading by those persons who may know the terms of the order placed into the automated system.
- 14. This approach is compatible with the existing provisions concerning customer order protection in Rule 5320 and its accompanying Supplementary Material concerning protection of customer limit and market orders and the implementation of effective information barriers.

- See Notice to Members 05-51 (August 2005); Notice to Members 97-57 (September 1997). Hedging and positioning activity around a customer block order was discussed in coordinated guidance published by both NASD and NYSE in 2005 with respect to volumeweighted average price transactions. See Notice to Members 05-51; NYSE Information Memo 05-52 (August 2005).
- 16. These transactions may include, for example, hedging or other positioning activity undertaken in connection with the handling of the customer order.
- 17. The Supplementary Material provides that a firm may obtain its customers' consent through affirmative written consent or through means of a negative consent letter. The negative consent letter must clearly disclose to the customer the terms and conditions for handling the customer's orders, and if the customer does not object, then the firm may reasonably conclude that the customer has consented and may rely on the letter. In addition, a firm may provide clear and comprehensive oral disclosure to, and obtain consent from, the customer on an order-byorder basis, provided the firm documents who provided the consent and the consent evidences the customer's understanding of the terms and conditions for handling the customer's order.
- IM-2110-3 also did not provide an exhaustive list of prohibited front running trading. See
   Notice to Members 87-69 (October 1987);
   Notice to Members 96-66 (October 1996).

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### 12-53

# Regulatory Relief Related to Hurricane Sandy

FINRA Waives Certain Trade Reporting and Compliance Engine (TRACE) Late Trade Reporting Fees in Connection With Hurricane Sandy

Due to significant disruptions in normal business operations as a result of Hurricane Sandy, which made landfall along the mid-Atlantic Coast on October 29, 2012, FINRA will waive<sup>1</sup> TRACE late trade reporting fees<sup>2</sup> if a firm in an area affected by Hurricane Sandy<sup>3</sup> reported certain transactions in TRACE-eligible securities late.<sup>4</sup> The late trade reporting fee will be waived for transactions that were executed on Monday, October 29, 2012, or Tuesday, October 30, 2012, by firms located in the affected areas (or that have their fixed income operations in the affected areas), provided that the affected firms reported the transactions no later than Wednesday, October 31, 2012, by the TRACE system closing.

FINRA has identified a number of transactions that qualify for the waiver of the late trade reporting fee of \$3.00, and will credit those firms with identified relevant transactions on their TRACE invoices for November 2012. However, upon receipt of the November invoice, if a firm has not received credit for transaction(s) it believes qualify for the fee waiver because its fixed income operations are located in one of the affected areas, the firm should contact TRACE Data Services by emailing *TRACEDataServices@finra.org* or calling (888) 507-3665, and provide a list of the transactions and the reason the transactions qualify for the waiver.

Questions regarding this Notice may be directed to:

- Nils Ola Persson, Vice President, Transparency Services, at (212) 858-4796; or
- ► Kathryn M. Moore, Assistant General Counsel, Office of General Counsel, at (202) 974-2974.

### December 2012

### **Notice Type**

► Guidance

### Suggested Routing

- ► Compliance
- ► Fixed Income
- ► Legal
- ▶ Operations
- ► Systems

### **Key Topics**

- ► TRACE Fee Waiver
- ► Late Transaction Reporting

#### Referenced Rules & Notices

- ► FINRA Rule 6730
- ► FINRA Rule 7730



### **Endnotes**

- See Securities Exchange Act Release
   No. 68325 (November 30, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2012-051).
- 2. See FINRA Rule 7730(b)(3).
- 3. An affected area means any area, such as a state or a county, that the President declared a major disaster or for which the President signed a federal emergency declaration as a result of Hurricane Sandy (e.g., the state, or certain counties, of Connecticut, New York, New Jersey, Delaware, District of Columbia, Maryland, Massachusetts, New Hampshire, Pennsylvania, Rhode Island, Virginia and West Virginia) (the "affected areas").
- 4. See FINRA Rule 6730(a).

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## 12-54

### Financial Reporting Relief

Reporting Relief Relating to Customer and PAIB Reserve Formula Computations and Required Deposits Around the December 2012 Month-End Holidays

### **Executive Summary**

FINRA is notifying firms that staff of the Division of Trading and Markets of the Securities and Exchange Commission (SEC staff) is granting an optional one-day extension—around the December 2012 month-end holidays—to firms for making the deposit of amounts required to be reserved pursuant to SEA Rule 15c3-3. These reserved amounts are based on the Customer and PAIB reserve formula computations prescribed by SEA Rule 15c3-3(e)(3) and computed as of Friday, December 21 and Friday, December 28, 2012.<sup>1</sup>

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.

### **Background and Discussion**

### Weekly Reserve Formula Computation Deposit Requirement

Because the 2012 Christmas Day and 2013 New Year's Day holidays occur on Tuesdays, SEC staff is granting an optional one-day extension to firms for making the requisite SEA Rule 15c3-3 Reserve Bank Account deposit(s) based on the Friday, December 21 and Friday, December 28 weekly Customer and PAIB reserve formula computations. This extension recognizes that many firm employees may take off Monday, December 24 and Monday, December 31.

### December 2012

### **Notice Type**

► Guidance

### Suggested Routing

- Capital and Accounting Staff
- ► Compliance
- ► Chief Financial Officer
- ► Executive Representative
- ► Legal
- ► Senior Management

### **Key Topics**

- Customer Reserve Formula Computation
- ► FOCUS Filing
- ► PAIB Reserve Formula Computation
- ► Reserve Bank Account Deposit

#### Referenced Rules & Notices

► SEA Rule 15c3-3



The revised deadlines are noted below:

### Revised Weekly Reserve Formula Computation Deposit Requirement

Week Ending	Original Deadline Date	Extension Date
Friday, December 21	Wednesday, December 26	Thursday, December 27
Friday, December 28	Wednesday, January 2	Thursday, January 3

### Month-End Reserve Formula Computation Deposit Requirement

Firms that report their financials and file a FOCUS report as of the last business day of each month would be required to compute their month-end Customer and PAIB reserve formula calculations as of Monday, December 31, 2012, and to make any requisite SEA Rule 15c3-3 Reserve Bank Account deposit(s) on Thursday, January 3, 2013. Further, pursuant to SEA Rule 15c3-3(e)(3)/01 (Weekly Computation), firms that prepare the month-end Customer and PAIB reserve formula computations as of Monday, December 31, would not be required to prepare the weekly Customer and PAIB reserve formula computations as of the following Friday, January 4, 2013.

As a result of the optional one-day extension on the weekly computations, firms that report their financials as of the last business day of the month and also elect to use the one-day extension may be subject to double deposit(s) on Thursday, January 3, 2013. The double deposit(s) would result from the weekly and month-end Customer and PAIB reserve formula computations required to be computed as of Friday, December 28 and Monday, December 31, respectively. To avoid this duplication, firms may elect to prepare their Friday, January 4, weekly Customer and PAIB reserve formula computation in lieu of the Friday, December 28, weekly computations. This option is only available for December 2012 for firms that report their financials as of the last business day of the month.

### **Endnotes**

 Paragraph (e)(3) of SEA Rule 15c3-3 requires a broker-dealer to prepare the reserve formula computations, necessary to determine the amount required to be deposited as specified in paragraph (e)(1) of SEA Rule 15c3-3, to be made weekly, as of the close of the last business day of the week, and the deposit so computed to be made no later than one hour after the opening of banking business on the second following business day.

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# 12-55

### Suitability

### **Guidance on FINRA's Suitability Rule**

### **Executive Summary**

In November 2010, the Securities and Exchange Commission (SEC) approved FINRA Rule 2111 (Suitability), which became effective on July 9, 2012. In May 2012, FINRA issued <u>Regulatory Notice 12-25</u>, which provides guidance on the rule in a "frequently asked questions" (FAQ) format. This Notice addresses two issues discussed in <u>Regulatory Notice 12-25</u>: the scope of the terms "customer" and "investment strategy." In addition, FINRA has created a <u>suitability Web page</u> that, among other things, will locate in one place questions and answers regarding FINRA Rule 2111.

Questions regarding this *Notice* should be directed to:

- James S. Wrona, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8270; or
- ▶ Matthew E. Vitek, Assistant General Counsel, OGC, at (202) 728-8156.

### Discussion

FINRA Rule 2111 requires, in part, that a broker-dealer or registered representative "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer" based on the customer's investment profile.<sup>3</sup> In <u>Regulatory Notice 12-25</u>, FINRA addressed the scope of the terms "customer" and "investment strategy" in FAQ 6, 7 and 10. The answers to those questions are superseded by the answers provided below in this *Notice*.

### December 2012

### **Notice Type**

► Guidance

### **Suggested Routing**

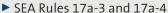
- ► Compliance
- ► Legal
- ► Senior Management

### **Key Topics**

- ▶ Customer
- ► Investment Strategies
- Outside Business Activities
- ► Recommendation
- ► Suitability
- ► Supervision

### Referenced Rules and Notices

- ► FINRA Rule 0160
- ► FINRA Rule 2010
- ► FINRA Rule 2020
- ► FINRA Rule 2090
- ► FINRA Rule 2111
- ► FINRA Rule 2210
- ► FINRA Rule 3270
- ► FINRA Rule 4512 ► NASD Rule 2210
- ► NASD Rule 3010
- NIACD D. I. 2040
- NASD Rule 3040
- ► NTM 05-50
- ► NTM 04-89
- ► NTM 04-72
- ► NTM 01-23
- ► NTM 99-45
- ► Regulatory Notice 12-25
- ► Regulatory Notice 11-25
- ► Regulatory Notice 11-02
- ► Regulatory Notice 10-22
- ► Regulatory Notice 10-06
- ► Regulatory Notice 08-35





#### Customer

Question 6 from Regulatory Notice 12-25 is now 6(a) with a new answer

- Q6(a). What constitutes a "customer" for purposes of the suitability rule?
- A6(a). The suitability rule applies to a broker-dealer's or registered representative's recommendation of a security or investment strategy involving a security to a "customer." FINRA's definition of a customer in FINRA Rule 0160 excludes a "broker or dealer." In general, for purposes of the suitability rule, the term customer includes a person who is not a broker or dealer who opens a brokerage account at a broker-dealer or purchases a security for which the broker-dealer receives or will receive, directly or indirectly, compensation even though the security is held at an issuer, the issuer's affiliate or a custodial agent (e.g., "direct application" business, "investment program" securities, or private placements, or using another similar arrangement.

New question and answer 6(b)

- Q6(b). Does the suitability rule apply when a broker-dealer or registered representative makes a recommendation to a potential investor?
- A6(b). The suitability rule would apply when a broker-dealer or registered representative makes a recommendation to a potential investor who then becomes a customer. Where, for example, a registered representative makes a recommendation to purchase a security to a potential investor, the suitability rule would apply to the recommendation if that individual executes the transaction through the broker-dealer with which the registered representative is associated or the broker-dealer receives or will receive, directly or indirectly, compensation as a result of the recommended transaction. In contrast, the suitability rule would not apply to the recommendation in the example above if the potential investor does not act on the recommendation or executes the recommended transaction away from the broker-dealer with which the registered representative is associated without the broker-dealer receiving compensation for the transaction.

### **Investment Strategy**

### Question 7 from Regulatory Notice 12-25 with a new answer

- Q7. The new suitability rule requires that a recommended investment strategy involving a security or securities must be suitable. Can you provide some examples of what would and would not be considered an "investment strategy" under the rule?
- A7. Rule 2111 states that the term "investment strategy" is to be interpreted "broadly." However, FINRA would not consider a broker-dealer's or registered representative's recommendation that a customer generally invest in "equity" or "fixed income" securities to be an investment strategy covered by the rule, unless such a recommendation was part of an asset allocation plan not eligible for the safe-harbor provision in Rule 2111.03 (discussed in FAQ 8). The "investment strategy" language would apply to recommendations to customers to invest in more specific types of securities, such as high dividend companies or the "Dogs of the Dow," or in a market sector, regardless of whether the recommendations identify particular securities. It also would apply to recommendations to customers generally to use a bond ladder, day trading, "liquefied home equity," or margin strategy involving securities, irrespective of whether the recommendations mention particular securities.

In addition, the term would capture an *explicit* recommendation to *hold* a security or securities or to continue to use an investment strategy involving a security or securities.<sup>17</sup> The rule would apply, for example, when a registered representative meets (or otherwise communicates) with a customer during a quarterly or annual investment review and explicitly advises the customer not to sell any securities in or make any changes to the account or portfolio or to continue to use an investment strategy. However, as explained in FAQ 3, the rule would not cover an implicit recommendation to hold.

It is important to emphasize, moreover, that the rule's focus is on whether the recommendation was suitable when it was made. A recommendation to hold securities, maintain an investment strategy involving securities or use another investment strategy involving securities—as with a recommendation to purchase, sell or exchange securities—normally would not create an ongoing duty to monitor and make subsequent recommendations.

Question 10 from *Regulatory Notice* 12-25 is now 10(a) with a new answer

- Q10(a). Does the new rule's "investment strategy" language cover a registered representative's recommendation involving both a security and a non-security investment?
- A10(a). The new suitability rule would continue to cover a broker-dealer's or registered representative's recommendation of an "investment strategy" involving both a security and a non-security investment. Suitability obligations apply, for example, to a broker-dealer's or registered representative's recommendation of an investment strategy to use home equity to purchase securities or to liquidate securities to purchase an investment-related product that is not a security.

However, where a broker-dealer's or registered representative's recommendation does not refer to a security or securities, the suitability rule is not applicable. The suitability rule would not apply, for instance, if a registered representative recommends a non-security investment as part of an outside business activity and the customer separately decides on his or her own to liquidate securities positions and apply the proceeds toward the recommended non-security investment.<sup>21</sup> Where a customer, absent a recommendation by a registered representative, decides on his or her own to purchase a non-security investment and then asks the registered representative to recommend which securities he or she should sell to fund the purchase of the non-security investment, the suitability rule would apply to the registered representative's recommendation regarding which securities to sell but not to the customer's decision to purchase the non-security investment.

New question and answer 10(b)

- Q10(b). What are a broker-dealer's supervisory responsibilities for a registered representative's recommendation of an investment strategy involving both a security and a non-security investment?
- A10(b). FINRA's supervision rules do not dictate the exact manner in which a broker-dealer must supervise its registered representatives' recommendations of investment strategies involving a security and a non-security investment. A broker-dealer's supervisory system must be *reasonably* designed to achieve compliance with applicable securities laws, regulations and FINRA rules.<sup>22</sup> The reasonableness of a supervisory system will depend on the facts and circumstances. As FINRA has stated previously, "FINRA appreciates that no two [broker-dealers] are exactly alike. [Broker-dealers] have different business models; offer divergent services, products and investment strategies; and employ distinct approaches to complying with applicable regulatory requirements."<sup>23</sup> A broker-dealer can consider a variety of approaches to identifying and supervising its registered representatives' recommendations of investment strategies involving both a security and a non-security component.

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A broker-dealer may use a risk-based approach to supervising its registered representatives' recommendations of investment strategies with both a security and non-security component. For instance, as long as the supervisory system is reasonably designed to achieve compliance with applicable securities laws, regulations and FINRA rules, a firm could focus on the detection, investigation and follow-up of "red flags" indicating that a registered representative may have recommended an unsuitable investment strategy with both a security and non-security component.<sup>24</sup> A registered representative's recommendation that a customer with limited means purchase a large position in a security might raise a "red flag" regarding the source of funds for such a purchase. Similarly, a registered representative's recommendation that a "buy and hold" customer with an investment objective of income liquidate large positions in blue chip stocks paying regular dividends might raise a "red flag" regarding whether that recommendation is part of a broader investment strategy.

Once a broker-dealer identifies a recommended investment strategy involving both a security and a non-security investment, the broker-dealer's suitability obligations apply to the security component of the recommended strategy<sup>25</sup> but its suitability analysis also must be informed by a general understanding of the non-security component of the recommended investment strategy. In the context of a recommended investment strategy involving a security and an outside business activity, the broker-dealer's general understanding of the outside business activity would be based on the information and considerations required by FINRA Rule 3270.<sup>26</sup>

Finally, broker-dealers must keep in mind that, in addition to suitability and supervisory responsibilities, firms have other regulatory obligations to investigate unusual activity.

### **Endnotes**

- See 75 Fed. Reg. 71479 (Nov. 23, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2010-039); Regulatory Notice 11-25. In addition, the SEC's order approved FINRA Rule 2090 (Know Your Customer), which also became effective on July 9, 2012. Id.
- For purposes of this Notice, a reference to a numbered FAQ means the FAQ from Regulatory Notice 12-25.
- 3. FINRA Rule 2111(a).
- See FINRA Rule 0160(b)(4) (Definition of Customer).
- 5. See Notice to Members 04-72, at 846 ("The BD of record refers to the broker-dealer identified on a customer's account application for accounts held directly at a mutual fund or variable insurance product issuer. Accounts held in this manner are sometimes referred to as 'check and application,' 'application way,' or 'direct application' . . . business.").
- 6. <u>Regulatory Notice 08-35</u>, at 2 (stating that direct participation programs (DPPs) and unlisted real estate investment trusts (REITs) are referred to as "investment programs").
- <u>Regulatory Notice 10-22</u> (discussing broker-dealer obligations for certain private placements).
- 8. Nothing in this guidance shall be construed as altering a broker-dealer's obligations under applicable federal laws, regulations and rules or other FINRA rules, including, but not limited to, Sections 9, 10(b) and 15(c) of the Securities Exchange Act of 1934, Section 17(a) of the Securities Act of 1933, the Bank Secrecy Act, 31 U.S.C. §§ 5311, et seq. and the implementing regulations promulgated thereunder by the Department of the Treasury; SEA Rules 17a-3

- and 17a-4; and FINRA Rules 2090 (Know Your Customer) and 4512 (Customer Account Information).
- FINRA reiterates that the suitability rule applies only if a broker-dealer or registered representative makes a "recommendation." FINRA previously has provided guiding principles that firms and registered representatives could consider when determining whether a particular communication could be viewed as a recommendation for purposes of the suitability rule. See, e.g., FAQ 2 (discussing the term "recommendation" and citing various resources that explain the guiding principles that firms could use when analyzing whether a communication constitutes a recommendation); Regulatory Notice 11-02, at 2-3 (discussing FINRA's guiding principles); Regulatory Notice 10-06, at 3-4 (providing guidance on recommendations made on blogs and social networking websites); Notice to Members 01-23 (announcing the guiding principles and providing examples of communications that likely do and do not constitute recommendations); Michael F. Siegel, Exchange Act Rel. No. 58737, 2008 SEC LEXIS 2459, at \*21-27 (Oct. 6, 2008) (applying the guiding principles to the facts of the case to find a recommendation), aff'd in relevant part, 592 F.3d 147 (D.C. Cir.), cert. denied, 130 S.Ct. 3333 (2010).
- 10. In the example above regarding a recommendation to a *potential investor*, suitability obligations attach when the transaction occurs, but the suitability of the recommendation is evaluated based on the circumstances that existed at the time the recommendation was made. However, when a broker-dealer or registered representative makes a recommendation to a *customer* (as opposed

- to a *potential investor*), suitability obligations attach at the time the recommendation is made, irrespective of whether a transaction occurs. *See Regulatory Notice* 11-25, at 6; *Regulatory Notice* 11-02, at 3.
- 11. Depending on the facts and circumstances, a registered representative's recommendation to a potential investor also could raise concerns under, among other rules, FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade); FINRA Rule 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices); Rule 2210 (Communications with the Public); and NASD Rule 3040 (Private Securities Transactions of an Associated Person); see also Dep't of Enforcement v. Salazar, No. 20100224056, 2012 FINRA Discip. LEXIS 22 (Mar. 12, 2012) (finding that registered representative violated NASD Rules 2310 and 3040 when he recommended unsuitable private securities transactions to investors who were not his firm's customers, received compensation in relation to the transactions and failed to notify his firm of such activity); Maximo J. Guevara, 54 S.E.C. 655, 2000 SEC LEXIS 986 (2000) (holding that registered representative violated NASD Rules 2310 and 3040 where he recommended unsuitable securities that were sold away from the firm with which he was associated without providing his firm prior notice of such activities).
- 12. See FINRA Rule 2111.03.
- 13. See id. As described in greater detail in FAQ 8, there is a safe harbor for certain types of educational information and asset allocation models that otherwise could be considered investment strategies captured by the new rule.

- 14. The "Dogs of the Dow" strategy is premised on investing "equal dollar amounts in the ten constituents of the Dow Jones industrial average with the highest dividend yields, hold[ing] them for twelve months and then switch[ing] to a new group of dogs." Vincent Apicella, Stock Focus: "Dogs of the Dow" Companies, Forbes.com (May 29, 2001).
- 15. The rule would apply, for instance, to a registered representative's recommendation to a customer to purchase shares of high dividend companies even though the registered representative does not mention a *particular* high dividend company.
- 16. See <u>Notice to Members 04-89</u> (discussing liquefied home equity).
- 17. See FINRA Rule 2111.03.
- 18. While the suitability rule applies only to recommendations involving a security or securities, other FINRA rules potentially apply, depending on the facts of the particular case, to broker-dealers' or registered representatives' conduct that does not involve securities. See, e.g., FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade); FINRA Rule 3270 (Outside Business Activities of Registered Persons); Rule 2210 (Communications with the Public); see also laleggio v. SEC, No. 98-70854, 1999 U.S. App. LEXIS 10362, \*4-5 (9th Cir. May 20, 1999) (holding that FINRA's requirement that registered representatives act in a manner consistent with just and equitable principles of trade applies to all unethical business conduct, regardless of whether the conduct involves securities); Vail v. SEC, 101 F.3d 37, 39 (5th Cir. 1996) (same); Robert L. Wallace, 53 S.E.C. 989, 995, 1998 SEC LEXIS 2437, at \*13 (1998) (emphasizing, in an action involving viatical settlements, that Rule 2210 is "not limited to advertisements for securities, but provide[s] standards applicable to all [broker-dealer] communications with the public").

- 19. FINRA made similar points regarding recommended investment strategies on several occasions under the predecessor suitability rule. FINRA explained in one instance under the predecessor rule that "recommending liquefying home equity to purchase securities may not be suitable for all investors. [Broker-dealers or registered representatives] should consider not only whether the recommended investments are suitable, but also whether the strategy of investing liquefied home equity in securities is suitable." Notice to Members 04-89, at 3. See also Donna M. Vogt, AWC No. EAF0400730002 (Feb. 21, 2007) (barring registered representative for, among other things, recommending to ten customers, many of whom were nearing retirement, that they obtain home equity loans and use the proceeds to purchase securities, without considering whether such recommendations were suitable for such customers in light of their financial situation and needs); James A. Kenas, AWC No. C3B040001 (Jan. 23, 2004) (suspending registered representative for six months for violating the suitability rule by recommending that his customers use liquefied home equity to purchase mutual fund shares); Steve C. Morgan, AWC No. C3A040016 (Mar. 9, 2004) (suspending registered representative for six months and ordering him to pay restitution of more than \$15,000 for recommending that a retired couple use liquefied home equity to purchase a variable annuity).
- 20. See Notice to Members 05-50, at 5

  ("[R]ecommendations to liquidate or surrender a registered security such as a mutual fund, variable annuity, or variable life contract must be suitable, including where such liquidations or surrender[s] are for the purpose of funding the purchase of an unregistered [equity indexed annuity].").

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- 21. FINRA Rule 3270.01 (Outside Business Activities of Registered Persons) requires a broker-dealer, upon receipt of a registered person's written notice of a proposed outside business activity, to consider whether the proposed activity will "interfere with or otherwise compromise the registered person's responsibilities to the [brokerdealer or the broker-dealer's customers or be viewed by customers or the public as part of the [broker-dealer's] business...." Id. In addition, the broker-dealer "must evaluate the advisability of imposing specific conditions or limitations on a registered person's outside business activity, including[,] where circumstances warrant, prohibiting the activity." Id. A broker-dealer "also must evaluate the proposed activity to determine whether the activity properly is characterized as an outside business activity or whether it should be treated as an outside securities activity subject to the requirement of NASD Rule 3040" (Private Securities Transactions of an Associated Person). Id. Furthermore, a broker-dealer "must keep a record of its compliance with these obligations with respect to each written notice received and must preserve this record for the period of time and accessibility specified in SEA Rule 17a-4(e)(1)." Id.
- 22. See NASD Rule 3010 (Supervision).
- 23. Regulatory Notice 12-25, at 2.
- 24. In Notice to Members 99-45, FINRA said that the supervision rule "requires that a [firm's] supervisory system be reasonably designed to achieve compliance with applicable laws and regulations. This standard recognizes that a supervisory system cannot guarantee firmwide compliance with all laws and regulations. However, this standard does require that the system be a product of sound thinking and within the bounds of common sense, taking into consideration the factors that are unique to a member's business." Id. at 295.

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- 25. For example, in supervising an identified recommended investment strategy involving a security and a non-security component, a broker-dealer may need to consider, in addition to the customer's investment profile, whether a recommended securities liquidation causes an overconcentration in particular securities or types of securities remaining in the account, changes the composition of the customer's remaining securities investments to an extent that the customer's portfolio no longer matches his or her investment profile, subjects the customer to early withdrawal fees or penalties, exposes the customer to losses because of the lack of a ready market for the securities at the time of the liquidation, or results in potential adverse tax treatment.
- 26. See also supra note 21 and discussion therein.

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# 12-56

# Trace Reporting and Compliance Engine (TRACE)

SEC Approves Amendments to TRACE Rules and Dissemination Protocols to Disseminate Specified Pool Transactions and SBA-Backed ABS Transactions and to Reduce the Time to Report Such Transactions

Effective Date: July 22, 2013

### **Executive Summary**

The SEC approved amendments to FINRA Rule 6700 Series and TRACE dissemination protocols that provide for the dissemination of transactions that are agency pass-through mortgage-backed securities traded in specified pool transactions and asset-backed securities¹ backed by loans guaranteed as to principal and interest by the Small Business Administration (SBA-backed ABS) and traded in specified pool transactions or to be announced (TBA), and reduce the time to report such transactions.² The effective date is July 22, 2013.

The amended rule text is available at www.finra.org/notices/12-56.

Questions regarding this Notice may be directed to:

- ► Elliot Levine, Associate Vice President and Counsel, Transparency Services, at (202) 728-8405; or
- ► Sharon Zackula, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8985.

### **Background and Discussion**

FINRA amended the TRACE rules and dissemination protocols to provide for the dissemination of agency pass-through mortgage-backed securities that are traded in specified pool transactions (MBS specified pool transactions) and SBA-backed ABS that are traded either in specified pool transactions or TBA (collectively, SBA-backed ABS transactions). FINRA also reduced the reporting periods for MBS specified pool and SBA-backed ABS transactions to improve

### December 2012

### **Notice Type**

► Rule Amendment

### Suggested Routing

- ► Compliance
- ► Fixed Income
- ► Legal
- ▶ Operations
- Systems
- ▶ Trading
- Training

### **Key Topics**

- Agency Pass-Through Mortgage-Backed Securities
- ► Asset-Backed Securities
- Dissemination
- ► SBA-Backed ABS
- ► Specified Pool Transactions
- ► To Be Announced (TBA)
- ► Transaction Reporting

#### Referenced Rules & Notices

- ► FINRA Rule 6710
- ► FINRA Rule 6730
- ► FINRA Rule 6750



the timeliness of the transaction information to be disseminated, and incorporated certain other amendments. The substantive amendments to the FINRA rules are as follows:

- ▶ **Dissemination.** FINRA amended Rule 6750(b)(4) to provide for the dissemination of MBS specified pool and SBA-backed ABS specified pool transactions and SBA-backed ABS transactions traded TBA immediately upon receipt of a transaction report.
  - FINRA modified the dissemination protocols for MBS and SBA-backed ABS specified pool transactions. In lieu of disseminating the CUSIP, FINRA will disseminate transaction information using reference data elements, in ranges (after truncating and rounding), that describe the characteristics of the traded pool. For example, for MBS specified pool transactions, FINRA will disseminate the coupon and weighted average coupon (WAC), the original maturity and weighted average maturity (WAM), the original loan-to-value (original LTV) and the average loan size (ALS), and the weighted average loan age (WALA), subject to display ranges. In addition, to identify the type of security traded, FINRA will disseminate the agency or government-sponsored-enterprise (GSE), product type and amortization type. Additional details regarding the information that will be disseminated initially, including sample values and display ranges, is set forth on Attachment A.
  - ► SBA-backed ABS transactions traded TBA will be subject to the same dissemination protocols established for MBS transactions traded TBA (e.g., the CUSIP will be disseminated).<sup>3</sup>
  - ► The dissemination cap for MBS specified pool transactions and SBA-backed ABS transactions will be \$10 million.
- ▶ **Reporting Time Periods.** FINRA amended Rule 6730 to establish requirements for reporting MBS specified pool and SBA-backed ABS transactions.
  - ► FINRA Rule 6730(a)(3)(F)(i) and FINRA Rule 6730(a)(3)(G)(i) provide that for a pilot program that will expire on January 24, 2014, MBS specified pool transactions and SBA-backed ABS transactions, respectively, must be reported no later than 120 minutes from the time of execution, subject to minor exceptions to the general requirement for transactions executed shortly before the TRACE system closes and when the TRACE system is closed.⁴
  - After January 24, 2014, FINRA Rule 6730(a)(3)(F)(ii) and FINRA Rule 6730(a) (3)(G)(ii) provide that MBS specified pool transactions and SBA-backed ABS transactions, respectively, must be reported no later than 60 minutes from the time of execution, subject again to exceptions to the reporting time frames for transactions executed shortly before the TRACE system closes and when the TRACE system is closed.<sup>5</sup>
- ▶ **Definitions.** FINRA adopted a definition of SBA-backed ABS in FINRA Rule 6710(bb). FINRA amended Rule 6710(u), the definition of "TBA," and FINRA Rule 6710(x), the definition of "specified pool transaction," to include references to transactions in SBA-backed ABS. FINRA incorporated minor, technical changes to the definition of "agency pass-through mortgage-backed security" in FINRA Rule 6710(v).

### **Attachment A**

### Dissemination of MBS Specified Pool Transactions and SBA-Backed ABS Specified Pool Transactions

Information regarding the data elements and display details, including sample values and display ranges (after truncating and rounding), that FINRA will disseminate initially for MBS specified pool transactions and SBA-backed ABS specified pool transactions is set forth below.

Data Element to be Disseminated	MBS Specified Pool Transaction Dissemination	SBA-Backed ABS Specified Pool Transaction Dissemination	Sample Values <sup>6</sup>
Product Type	The type of properties (or real-estate projects) subject to the mortgage underlying the MBS. For example, single family residential dwelling mortgage loans, multifamily residential dwelling mortgage loans or project loans.	Not Applicable.	Single Family Multi-Family Project
Amortization Type	Identification of the underlying mortgage types. For example, level payment, adjustable rate mortgages (ARM) or balloon payment.	Identification of the underlying loan type. For example, level payment or variable interest rate.	Level Payment ARM Balloon
Issuing Agency	The agency or GSE that issues the certificate and guaranteed the payment of principal and interest of the MBS: Fannie Mae, Freddie Mac or Ginnie Mae.	Small Business Administration.	Fannie Mae Freddie Mac Ginnie Mae Small Business Administration
Coupon	The stated annual percentage rate of interest.	The stated annual percentage rate of interest.	Coupon will be disseminated after rounding down to the nearest quarter percentage point. For example, an interest rate of 5.12 percent will be disseminated as 5 percent.

Data Element to be Disseminated	MBS Specified Pool Transaction Dissemination	SBA-Backed ABS Specified Pool Transaction Dissemination	Sample Values <sup>6</sup>
Original Maturity	The original stated term after which the principal amount of the security is due to be repaid in full, or the end of the life of the MBS.	The original stated term after which the principal amount of the security is due to be repaid in full, or the end of the Iife of the SBA-backed ABS.	Original maturity is expressed in months and rounded up to the nearest 10. For example, an original maturity of 358 months will be disseminated as 360 months.
Weighted Average Coupon (WAC)	WAC is the weighted average interest rate of the underlying mortgage loans or pools that serve as collateral for a mortgage security, weighted by the size of the principal loan balances. It is calculated by weighting the interest rate of each mortgage loan in the pool by the amount of the mortgage outstanding.	WAC is the weighted average interest rate of the underlying SBA loans or pools that serve as collateral for the security, weighted by the size of the principal loan balances. It is calculated by weighting the interest rate of each SBA loan in the pool by the amount of the loan outstanding.	WAC will be disseminated after truncating to a single decimal. For example, a WAC of 7.13 percent will be disseminated as 7.1 percent.
Weighted Average Maturity (WAM)	WAM is the weighted average number of months to the final payment of each loan backing an MBS, weighted by the size of the principal loan balances. WAM is calculated by weighting the remaining number of months to maturity for each mortgage loan in the pool by the amount of the mortgage outstanding.	WAM is the weighted average number of months to the final payment of each loan backing an SBA-backed ABS, weighted by the size of the principal loan balances. WAM is calculated by weighting the remaining number of months to maturity for each loan in the pool by the amount of the loan outstanding.	WAM will be disseminated rounded down to the nearest 10. For example, a WAM of 87 months will be disseminated as 80 months.
Weighted Average Loan Age (WALA)	WALA is the weighted average number of months since the date of the loan origination of the mortgages (i.e., the age of the loans) backing an MBS, weighted by the size of the principal loan balances.	WALA is the weighted average number of months since the date of the loan origination of the loans (i.e., the age of the loans) backing an SBAbacked ABS, weighted by the size of the principal loan balances.	WALA will be disseminated rounded up to the nearest 10. For example, a WALA of 163 months will be disseminated as 170 months.

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Data Element to be Disseminated	MBS Specified Pool Transaction Dissemination	SBA-Backed ABS Specified Pool Transaction Dissemination	Sample Values <sup>6</sup>
Average Loan Size (ALS)	Current ALS is calculated by dividing the current mortgage loan outstanding principal balance by the number of loans that remain outstanding.	Not Applicable.	ALS will be rounded down to the nearest 25. For example, an ALS of 113 (i.e., \$113,000 average loan size) will be disseminated as 100.
Original Loan-to- Value (original LTV)	Original LTV ratio expresses the amount of a first mortgage lien as a percentage of the total appraised value of the real property for which the mortgage was made.	Not Applicable.	Original LTV will be rounded down to the nearest 25. For example, an original LTV of 92 percent will be disseminated as 75 percent.

### **Endnotes**

- The terms agency pass-through mortgagebacked security, specified pool transaction and asset-backed security are defined in FINRA Rule 6710(v), FINRA Rule 6710(x) and FINRA Rule 6710(m), respectively.
- See Securities Exchange Act Release No. 68084 (October 23, 2012), 77 FR 65436 (October 26, 2012) (SEC Approval Order of File No. SR-FINRA-2012-042).
- In addition to CUSIP, other standard data elements disseminated for such transactions include the price, time of transaction, size (subject to dissemination caps), counterparty type (customer or dealer) and buy/sell indicator.

- 4. See FINRA Rule 6730(a)(3)(F)(i) and FINRA Rule 6730(a)(3)(G)(i), each of which incorporates by reference FINRA Rule 6730(a)(3)(E)(i)a. through d.
- 5. See FINRA Rule 6730(a)(3)(F)(ii) and FINRA Rule 6730(a)(3)(G)(ii), each of which incorporates by reference FINRA Rule 6730(a)(3)(E)(ii)a. through d.
- The sample values are for illustration purposes only. TRACE technical specifications will include more specific descriptions of the fields and the values to be disseminated.

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## 12-57

### **Mediator Classification**

SEC Approves Amendments to FINRA Dispute Resolution, Inc. By-Laws to Classify Mediators as Public Members if They Are Not Otherwise Disqualified From Being Classified as Public Members

Effective Date: January 22, 2013

### **Executive Summary**

The SEC approved amendments to the FINRA Dispute Resolution, Inc. By-Laws to clarify that services provided by mediators, when acting in such capacity and not representing parties in mediation, should not cause the individuals to be classified as industry members under the By-Laws.<sup>1</sup>

The amendments are effective on January 22, 2013, and apply to nominations of mediators by the FINRA Dispute Resolution, Inc. Board for membership on the National Arbitration and Mediation Committee submitted on or after this date. The text of the amendments is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- Kenneth L. Andrichik, Senior Vice President, Chief Counsel and Director of Mediation and Strategy, Dispute Resolution, at (212) 858-3915 or ken.andrichik@finra.org; or
- ► Mignon McLemore, Assistant Chief Counsel, Dispute Resolution, at (202) 728-8151 or *mignon.mclemore@finra.org*.

### **Background and Discussion**

Mediators are neutrals who guide parties toward a joint solution to resolve their disputes. Mediators are retained only by agreement of all parties to a dispute rather than by any one party, and the parties compensate mediators jointly pursuant to that agreement. Further, mediators do not represent any party in the mediation and have no power to decide the outcome of the dispute. In light of the unique role mediators play in FINRA's forum, FINRA

### December 2012

### **Notice Type**

► Rule Amendment

### Suggested Routing

- ► Compliance
- ► Legal
- ► Senior Management

### **Key Topics**

- ► Mediators
- ► Mediations
- ► Industry Members
- ► Public Members

#### Referenced Rules & Notices

- ➤ Dispute Resolution By-Laws, Article I(s)
- ▶ Dispute Resolution By-Laws, Article I(x)



does not believe the services mediators provide should cause these individuals to be classified as industry members under the By-Laws, thus, making them ineligible to serve as a public member of the National Arbitration and Mediation Committee (NAMC).² FINRA has, therefore, amended the definitions of industry members³ and public members⁴ in the By-Laws so that services provided by mediators, while acting in such capacity and not representing parties in mediation, would not cause these individuals to be classified as industry members.

FINRA has amended two parts of the definition of industry member.<sup>5</sup> First, Article I(s) (4) of the By-Laws defines an industry member as a committee member who provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the member or 20 percent or more of the gross revenues received by the member's firm or partnership.<sup>6</sup> As amended, the definition exempts any services provided in the capacity as a mediator of disputes involving a broker or dealer and not representing any party in such mediations from being considered professional services provided to brokers or dealers.

Second, Article I(s)(5) of the By-Laws defines an industry member as a committee member who provides professional services to a director, officer or employee of a broker, dealer or corporation that owns 50 percent or more of the voting stock of a broker or dealer, and such services relate to the director's, officer's or employee's professional capacity and constitute 20 percent or more of the professional revenues received by the member or 20 percent or more of the gross revenues received by the member's firm or partnership.<sup>7</sup> Similar to the change in Article I(s)(4), FINRA has amended the definition to exempt any services provided in the capacity as a mediator of disputes involving a director, officer or employee as described in this definition and not representing any party in such mediations from being considered professional services provided to such individuals.

FINRA has also amended the definition of public member under the By-Laws. A public member is defined as a committee member who has no material business relationship with a broker or dealer or a self-regulatory organization registered under the Securities Exchange Act (other than serving as a public director or public member on a committee of such a self-regulatory organization). As amended, the definition clarifies that acting in the capacity as a mediator of disputes involving a broker or dealer and not representing any party in such mediations is not considered a material business relationship with a broker or dealer.

The amendments prevent mediation activity from automatically classifying the mediator as an industry member under the By-Laws. The amendments do not, however, shield a mediator from being classified as an industry member because of activities that would otherwise cause the mediator to be considered an industry member. For example, if a mediator was an employee of a broker or dealer within the prior year, FINRA would classify the mediator as an industry member under the By-Laws.

### **Effective Date Provisions**

The amendments are effective on January 22, 2013, and apply to nominations of mediators by the FINRA DR Board for membership on the National Arbitration and Mediation Committee submitted on or after this date.

### **Endnotes**

- See Securities Exchange Act Rel. No. 68142
   (Nov. 2, 2012), 77 FR 67038 (Nov. 8, 2012)
   (Order Approving Proposed Rule Change to
   Amend the By-Laws of FINRA Dispute Resolution,
   Inc. to Clarify That Services Provided by Mediators
   Should Not Cause Them to Be Classified as
   Industry Members Under the By-Laws)
   (File No. SR-FINRA-2012-040).
- 2. The NAMC is a committee appointed by the Board of Directors of FINRA Dispute Resolution, Inc. (FINRA DR). It is comprised of a majority of public members and advises the FINRA DR Board on the development and maintenance of FINRA's Dispute Resolution forum. See Plan of Allocation and Delegation of Functions by FINRA to Subsidiaries NASD Dispute Resolution, §III(C) (1)(b). See also Rules 12102(a) and 12102(a)(1) of the Code of Arbitration Procedure for Customer Disputes and Rules 13102(a) and 13102(a)(1) of the Code of Arbitration Procedure for Industry Disputes.
- See Dispute Resolution By-Laws, Article I(s) (Definitions – Industry Member).
- 4. See Dispute Resolution By-Laws, Article I(x) (Definitions Public Member).
- The By-Laws define an industry member using six criteria. The proposal would amend two of them, subsections (4) and (5). See note 3, supra.
- The amendments in this definition would also apply to classifications for directors, defined as members of the Board, under the By-Laws.
   See Dispute Resolution By-Laws, Article I(j) (Definitions – Director).
- 7. Id.

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### **ATTACHMENT A**

New language is underlined; deleted language is in brackets.

### By-Laws of FINRA Dispute Resolution, Inc.

### **ARTICLE I DEFINITIONS**

When used in these By-Laws, unless the context otherwise requires, the term:

- (a) (r) No change;
- (s) "Industry Member" means a committee member who (1) is or has served in the prior year as an officer, director, employee or controlling person of a broker or dealer, excluding an independent director, an outside director, or a director not engaged in the day-to-day management of a broker or dealer; (2) is an officer, director (excluding an outside director), or employee of an entity that owns more than ten percent of the equity of a broker or dealer, and the broker or dealer accounts for more than five percent of the gross revenues received by the consolidated entity; (3) owns more than five percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed ten percent of his or her net worth, or whose ownership interest otherwise permits him or her to be engaged in the day-to-day management of a broker or dealer; (4) provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the Director or member or 20 percent or more of the gross revenues received by the Director's or member's firm or partnership (except that any services provided in the capacity as a mediator of disputes involving a broker or dealer and not representing any party in such mediations shall not be considered professional services provided to brokers or dealers); (5) provides professional services to a director, officer, or employee of a broker, dealer, or corporation that owns 50 percent or more of the voting stock of a broker or dealer, and such services relate to the director's, officer's, or employee's professional capacity and constitute 20 percent or more of the professional revenues received by the Director or member or 20 percent or more of the gross revenues received by the Director's or member's firm or partnership (except that any services provided in the capacity as a mediator of disputes involving a director, officer, or employee as described in this subsection (5) and not representing any party in such mediations shall not be considered professional services provided to such individuals); or (6) has a consulting or employment relationship with or provides professional services to a self regulatory organization registered under the Act, or has had any such relationship or provided any such services at any time within the prior year;

- (t) (w) No change;
- (x) "Public Member" means a committee member who has no material business relationship with a broker or dealer or a self regulatory organization registered under the Act (other than serving as a public director or public member on a committee of such a self regulatory organization or acting in the capacity as a mediator of disputes involving a broker or dealer and not representing any party in such mediations);
  - (y) No change.

## 12-58

### Foreign Equity Securities

### SEC No-Action Guidance Expanding the Definition of "Ready Market" for Certain Foreign Equity Securities

### **Executive Summary**

The staff of the Division of Trading and Markets of the Securities and Exchange Commission (SEC staff) has issued a no-action letter¹ setting forth conditions under which broker-dealers may treat certain foreign equity securities as having a "ready market" under SEA Rule 15c3-1(c)(11)(i) and subject to the haircuts under SEA Rule 15c3-1(c)(2)(vi)(J) (the no-action letter). This expands the number of foreign securities eligible as foreign margin stock under Regulation T of the Board of Governors of the Federal Reserve System.²

The text of the SEC staff's no-action letter is located on the SEC's website.

Questions concerning this Notice should be directed to:

- Rudolph R. Verra, Managing Director, Risk Oversight and Operational Regulation (ROOR), at (646) 315-8811;
- ► Glen Garofalo, Director, Credit Regulation, at (646) 315-8464;
- Steve Yannolo, Project Manager, Credit Regulation, at (646) 315-8621; or
- ▶ Yui Chan, Managing Director, ROOR, at (646) 315-8426.

### Background & Discussion

SEA Rule 15c3-1(c)(2)(vii) requires a broker-dealer to deduct 100 percent of the carrying value of securities it holds in its proprietary account for which there is no ready market, as defined in paragraph (c)(11) of the rule, or which cannot be publicly offered or sold because of statutory, regulatory or contractual arrangements or other restrictions. SEA Rule 15c3-1(c)(11)(i) provides that the term "ready market" includes "a market in which there exists independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom."

### December 2012

### **Notice Type**

- ► Guidance
- ► Suggested Routing
- ► Compliance
- ▶ Legal
- ► Margin Department
- ▶ Operations
- ► Regulatory Reporting
- ► Risk Management
- ► Senior Management

### **Key Topics**

- ► FTSE World Index
- ► Net Capital
- ► Foreign Equity Securities
- ► Foreign Margin Stock
- "Ready Market"

#### Referenced Rules & Notices

- FINRA Rule 4210
- ► Regulation T
- ► SEA Rule 15c3-1
- Securities Exchange Act of 1934



Currently under SEA Rule 15c3-1, broker-dealers may treat foreign equity securities that are listed on the FTSE World Index as having a "ready market," and subject to the haircut requirements under paragraph (c)(2)(vi)(J) of the rule.³ The FTSE World Index is currently limited to approximately 2,300 securities. FINRA member firms have expressed interest in expanding the criteria for recognizing foreign equity securities as having a "ready market" under SEA Rule 15c3-1 to include more than those that are listed on the FTSE World Index. Member firms have suggested that there are many more issuers of a substantial size for which there is a ready market within the meaning of SEA Rule 15c3-1. In response to such member firm interest, FINRA requested, and the SEC staff has granted, no-action relief to expand the definition of "ready market" regarding foreign equity securities. The SEC staff's no-action letter states that foreign equity securities will be deemed as having a "ready market" under SEA Rule 15c3-1(c)(11) and subject to haircuts under paragraph (c)(2)(vi)(J) of the rule if the following conditions are met:

- 1. The security is listed for trading on a foreign securities exchange located within a country that is recognized on the FTSE World Index, where the security has been trading on that exchange for at least the previous 90 days;
- 2. Daily quotations for both bid and ask or last sale prices for the security provided by the foreign securities exchange on which the security is traded are continuously available to broker-dealers in the United States, through an electronic quotation system;
- 3. The median daily trading volume (calculated over the preceding 20 business day period) of the foreign equity security on the foreign securities exchange on which the security is traded is either at least 100,000 shares or \$500,000<sup>4</sup>; and
- 4. The aggregate unrestricted market capitalization in shares of such security exceeds \$500 million over each of the preceding 10 business days.

The no-action letter states that any foreign equity security that ceases to meet one or more of the conditions set forth above will continue to be considered to have a "ready market" for five business days from the date the security ceases to meet the conditions. After the end of this five business day period, the security will be considered to have a "ready market" only if and when it again meets all of the conditions.

The SEC staff's no-action letter further provides:

▶ Broker-dealers may utilize the provisions of SEC Rule 15c3-1(c)(2)(vi)(J) to calculate the haircuts for foreign equity securities that meet all of the conditions set forth in the letter. However, a broker-dealer should perform this calculation independent of the haircut calculation for other securities subject to the provisions of SEA Rule 15c3-1(c)(2) (vi)(J).<sup>5</sup>

▶ Broker-dealers that choose to utilize the no-action relief would need to demonstrate, upon examination or inquiry, that any foreign equity security used as collateral for a margin loan met all of the conditions set forth in the letter, and to make and keep current, and maintain all relevant records in accordance with SEA Rules 17a-3 and 17a-4.

The no-action letter notes that FINRA expects that broker-dealers relying on the no-action relief will maintain appropriate risk management systems to monitor for concentration, volatility, and liquidity when extending credit secured by foreign securities, and should consider imposing higher "house" maintenance margin requirements as warranted. Measurements for computing such exposure should be reviewed at the individual account level as well as across all accounts held at the broker-dealer.

Finally, the no-action letter states that, pursuant to SEA Rule 15c3-1, if markets can absorb only a limited number of shares of an equity security for which a ready market exists, the non-marketable portion in the proprietary or other accounts of a broker-dealer is subject to a 100 percent deduction to net capital and is treated as a non-allowable asset consistent with current interpretations.<sup>6</sup>

The no-action letter addresses foreign equity securities. FINRA notes that member firms should be aware that options on such securities remain subject to the initial and maintenance margin requirements as set forth in FINRA Rule 4210(f)(2)(E)(iii).

### **Endnotes**

- See Letter from Michael A. Macchiaroli, Associate Director, Division of Trading and Markets, Securities and Exchange Commission, to Grace B. Vogel, Executive Vice President, Member Regulation, FINRA (November 28, 2012).
- Federal Reserve Regulation T (17 CFR 220.2)
  defines a foreign margin stock as a "foreign
  security that is an equity security that: (1)
  [a]ppears on the Board's periodically published
  List of Foreign Margin Stocks; or (2) [i]s deemed
  to have a 'ready market' under [SEA] Rule
  15c3-1... or a 'no-action' position issued
  thereunder."
- 3. See Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, Securities and Exchange Commission, to Dominic A. Carone, Chairman, Capital Committee, Securities Industry Association (August 13, 1993) (the 1993 Letter). The no-action letter states that the terms and conditions of the 1993 Letter with respect to foreign equity securities listed on the FTSE World Index will continue to apply after the issuance of the no-action letter. See also /02 of SEA Rule 15c3-1(c)(2)(vii) in the FINRA Interpretations of Financial and Operational Rules.
- 4. The no-action letter states that shares purchased by the computing broker-dealer during the preceding 20 business day period are to be excluded when determining the median trading volume. See also footnote 6 below.
- 5. The no-action letter states that a broker-dealer may combine foreign equity securities listed on the FTSE World Index under the conditions of the 1993 Letter and those foreign equity securities meeting the conditions of the no-action letter for purposes of calculating the haircuts specified under SEA Rule 15c3-1 (c)(2)(vi)(J).
- See Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, Commission, to Edward Kwalwasser, Senior Vice President, New York Stock Exchange, and Thomas R. Casella, Vice President, National Association of Securities Dealers (October 5, 1987) (the 1987 Letter). The no-action letter notes that, in the 1987 Letter, the SEC issued relief to a broker-dealer if, when faced with a blockage in securities, it treats as readily marketable securities that portion of the block which equals the aggregate of the most recent four-week, inter-dealer trading volume. The number of shares exceeding this amount should be considered non-marketable and subject to a 100 percent deduction from net capital and is treated as a non-allowable asset, unless the broker-dealer demonstrates to the satisfaction of its Designated Examining Authority that a ready market exists for these excess shares. The shares purchased by the computing broker-dealer during the most recent four-week period are to be excluded when determining trading volume. See also /01 of SEA Rule 15c3-1(c)(2)(vii) in the FINRA Interpretations of Financial and Operational Rules.

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# Information Notice

### 2013 Annual Audit, FOCUS and Supplemental Statement of Income (SSOI) Report Filing Deadlines

### **Executive Summary**

FINRA reminds firms of their obligation to file annual audit and Financial and Operational Combined Uniform Single (FOCUS) reports by the required due dates. All such filings must be received by FINRA by the required due date in order to avoid certain fees as set forth in FINRA's By-Laws. This *Notice* lists due dates for 2013.

Questions regarding this *Notice* should be directed to your firm's Regulatory Coordinator.

### Background

### **Annual Audit Report**

Securities Exchange Act (SEA) Rule 17a-5(d) requires, among other things, that every broker or dealer registered pursuant to Section 15 of the SEA file an annual audit report. A completed SEC Form X-17A-5 Part III (Facing Page) must accompany a member firm's annual audit report.<sup>1</sup>

Member firms may request an extension of time to file their annual audit report in accordance with the relevant policies posted on FINRA's website.<sup>2</sup>

Filings are due no later than 11:59 p.m. ET on the due dates listed in this Notice.

### December 3, 2012

### **Suggested Routing**

- ► Compliance
- ► Legal
- ► Operations
- ► Regulatory Reporting
- ► Senior Management

### Key Topic(s)

- ► Annual Audit Report
- ► FOCUS Filing

#### Referenced Rules and Notices

- ► NASD Rule 3170
- ► FINRA Rule 4524
- ► Regulatory Notice 11-46
- ► Regulatory Notice 12-11
- ► SEA Rule 17a-5



#### **Annual Audit Reports**

Period End	Due Date
December 31, 2012	March 1, 2013
January 31, 2013	April 1, 2013
February 28, 2013	April 29, 2013
March 31, 2013	May 30, 2013
April 30, 2013	July 1, 2013
May 31, 2013	July 30, 2013
June 30, 2013	August 29, 2013
July 31, 2013	September 30, 2013
August 31, 2013	October 30, 2013
September 30, 2013	November 29, 2013
October 31, 2013	December 30, 2013
November 30, 2013	January 29, 2014
December 31, 2013	March 1, 2014

As discussed in <u>Regulatory Notice 11-46</u>, and pursuant to NASD Rule 3170, FINRA is requiring member firms to submit their annual audit report in electronic form.<sup>3</sup> Firms must continue to file annual audit reports in hard copy form with the SEC as required pursuant to SEA Rule 17a-5(d)(6).

#### **FOCUS Reports**

FINRA member firms are required to submit FOCUS reports to FINRA pursuant to SEA Rule 17a-5. Member firms must submit their FOCUS reports electronically through the eFOCUS system available on the FINRA Firm Gateway. For information about completing the FOCUS report, please see the FOCUS filing submission guidance on FINRA's website.

# Monthly and Fifth<sup>4</sup> FOCUS II/IIA Filings

Period End	Due Date
November 30, 2012	December 26, 2012
January 31, 2013	February 26, 2013
February 28, 2013	March 25, 2013
April 30, 2013	May 23, 2013
May 31, 2013	June 25, 2013
July 31, 2013	August 23, 2013
August 31, 2013	September 25, 2013
October 31, 2013	November 25, 2013
November 30, 2013	December 24, 2013

# Quarterly FOCUS Part II/IIA Filings

Quarter Ending	Due Date
December 31, 2012	January 25, 2013
March 31, 2013	April 23, 2013
June 30, 2013	July 24, 2013
September 30, 2013	October 23, 2013
December 31, 2013	January 27, 2014

# Annual Schedule I Filings

Period	Due Date
2012	January 25, 2013
2013	January 27, 2014

# Supplemental Statement of Income (SSOI)

Pursuant to new FINRA Rule 4524, FINRA is requiring each member firm to file an SSOI, which is designed to provide more detailed categorization of the revenue and expense line items that are on the Statement of Income (Loss) page of the FOCUS report.<sup>5</sup> For information about completing the SSOI, please see the <u>Supplemental Statement of</u> Income (SSOI) page on FINRA's website.

#### **SSOI Filings**

Quarter Ending	Due Date
December 31, 2012	January 30, 2013
March 31, 2013	April 26, 2013
June 30, 2013	July 29, 2013
September 30, 2013	October 28, 2013
December 31, 2013	January 30, 2014

Questions regarding how to file FOCUS reports and reset passwords, and technical questions concerning system requirements, file uploads, and submission problems for the Firm Gateway should be directed to (800) 321-6273.

#### **Endnotes**

- The Facing Page requires basic identification information, including the name and address of the broker or dealer and its accountant, the oath or affirmation, and the itemization of materials included in the report.
- See Annual Audit Extension of Time Request <u>Policy</u> on FINRA's website. See also Section 4(g) of Schedule A to the FINRA By-Laws.
- 3. See <u>Regulatory Notice 11-46</u> (Annual Audit Reports: FINRA to Require Electronic Submission of Annual Audit Reports) (October 2011).
- 4. A Fifth FOCUS report is an additional report that is due from a member firm whose fiscal year end is a date other than the calendar quarter.
- 5. See <u>Regulatory Notice 12-11</u> (Supplemental FOCUS Information) (February 2012).

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# Information Notice

# 2013 Holiday Trade Date, Settlement Date and Margin Extensions Schedule

# **Executive Summary**

FINRA is providing the following schedule to assist member firms and reduce the number of Federal Reserve Board Regulation T and Securities Exchange Act Regulation 15c3-3 extensions denied around holidays. "Regular way" transactions made on the business days noted below will be subject to the following schedule.

Questions regarding this *Notice* should be directed to:

- ▶ Debra German, Senior Credit Regulation Coordinator, Risk Oversight and Operational Regulation (ROOR), at (646) 315-8467;
- ► Theresa Reynolds, Credit Regulation Coordinator, ROOR, at (646) 315-8567; or
- ▶ Vincent Rotolo, Senior Credit Specialist, ROOR, at (646) 315-8576.

# Background

Brokers, dealers and municipal securities dealers should use the following settlement dates for purposes of clearing and settling transactions pursuant to the securities exchanges.

As specified in Sections 220.4(d) and 220.8(b)(4) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a margin account or cash account if payment is not received within five business days from the date of purchase or, pursuant to Section 220.4(c)(3) and 220.8(d)(1), apply to extend the time period specified. The date by which firms must take such action is shown below in the column titled "Regulation T Date."

#### December 10, 2012

#### **Suggested Routing**

- ▶ Compliance
- ► Internal Audit
- ► Legal
- Municipal/Government Securities
- ▶ Operations
- ▶ Trading

#### Key Topic(s)

- ► Holiday Extension Dates
- ► Holiday Settlement Dates

#### Referenced Rules and Notices

- ► Regulation T 220.4 and 220.8
- ► SEA Rule 15c3-3



Similarly, SEA Regulation 15c3-3 requires firms to take prompt steps to obtain possession or control of securities pursuant to paragraph (m) through a buy-in procedure or otherwise if securities are not received within ten business days from the settlement date of the sale or, pursuant to paragraph (n), apply to extend the time period specified. The date by which firms must take such action is shown below in the column titled "SEC Extension Date."

All SEA Rule 15c3-3 extension requests **must be** received on the due dates listed below. Adherence to this procedure will reduce the number of denied requests for improper dates and establish uniformity among member firms.

SEA Rule 15c3-3 Subparagraph	Date Due
(d)(2)	on the 30th calendar day after settlement date
(d)(3)	on the 45th calendar day after settlement date
(h)	on the 45th calendar day after settlement date
(m)	on the 10th business day after settlement date

These dates also apply to a security listed on a foreign exchange. Firms must file SEA Rule 15c3-3 extensions on the appropriate dates regardless of the settlement cycle established by the foreign security market on which the security is traded.

#### New Year's Day:

The securities exchanges will be closed on **Tuesday**, **January 1**, **2013**, in observance of New Year's Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
December 24	December 28	January 2	January 14
26	31	3	15
27	January 2	4	16
28	3	7	17
31	4	8	18
January 1	N/A	N/A	N/A
2	7	9	22

#### Martin Luther King, Jr. Day:

The securities exchanges will be closed on **Monday, January 21, 2013**, in observance of Martin Luther King's birthday.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
January 14	January 17	January 22	February 1
15	18	23	4
16	22	24	5
17	23	25	6
18	24	28	7
21	N/A	N/A	N/A
22	25	29	8

## Presidents' Day:

The securities exchanges will be closed on **Monday, February 18, 2013**, in observance of Presidents' Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
February 11	February 14	February 19	March 1
12	15	20	4
13	19	21	5
14	20	22	6
15	21	25	7
18	N/A	N/A	N/A
19	22	26	8

#### **Good Friday:**

The securities exchanges will be closed on **Friday, March 29, 2013**, in observance of Good Friday.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
March 22	March 27	April 1	April 11
25	28	2	12
26	April 1	3	15
27	2	4	16
28	3	5	17
29	N/A	N/A	N/A
April 1	4	8	18

#### **Memorial Day:**

The securities exchanges will be closed on **Monday, May 27, 2013**, in observance of Memorial Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
May 20	May 23	May 28	June 7
21	24	29	10
22	28	30	11
23	29	31	12
24	30	June 3	13
27	N/A	N/A	N/A
28	31	4	14

## **Independence Day:**

The securities exchanges will be closed on **Thursday**, **July 4**, **2013**, in observance of Independence Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
June 27	July 2	July 5	July 17
28	3	8	18
July 1	5	9	19
2	8	10	22
3	9	11	23
4	N/A	N/A	N/A
5	10	12	24

## **Labor Day:**

The securities exchanges will be closed on **Monday, September 2, 2013**, in observance of Labor Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
August 26	August 29	September 3	September 13
27	30	4	16
28	September 3	5	17
29	4	6	18
30	5	9	19
September 2	N/A	N/A	N/A
3	6	10	20

#### **Columbus Day:**

The securities exchanges will be **open** for trading on Columbus Day, **Monday, October 14, 2013**. Therefore, it is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board. However, it will not be a settlement date because many of the nation's banking institutions will be closed.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
October 7	October 10	October 14	October 24
8	11	15	25
9	15	16	29
10	16	17	30
11	17	18	31
14	17	21	31
15	18	22	November 1

#### Veteran's Day:

The securities exchanges will be open for trading on Veteran's Day, **Monday, November 11, 2013**. Therefore, it is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board. However, it will not be a settlement date because many of the nation's banking institutions will be closed.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
November 4	November 7	November 11	November 21
5	8	12	22
6	12	13	26
7	13	14	27
8	14	15	29
11	14	18	29
12	15	19	December 2

#### **Thanksgiving Day:**

The securities exchanges will be closed on **Thursday, November 28, 2013**, in observance of Thanksgiving Day.

	Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
	November 21	November 26	November 29	December 11
	22	27	December 2	12
	25	29	3	13
	26	December 2	4	16
	27	3	5	17
	28	N/A	N/A	N/A
	29	4	6	18
- 1		I .	I .	I

#### **Christmas Day:**

The securities exchanges will be closed on **Wednesday**, **December 25**, **2013**, in observance of Christmas Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
December 18	December 23	December 26	January 8, 2014
19	24	27	9
20	26	30	10
23	27	31	13
24	30	January 2	14
25	N/A	N/A	N/A
26	31	3	15

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# **Election Notice**

# FINRA Announces Results of SFAB, NAC and District Committee Elections

## **Executive Summary**

FINRA recently concluded elections to fill vacant seats on the Small Firm Advisory Board (SFAB), National Adjudicatory Council (NAC) and district committees. This *Notice* lists the individuals elected to fill vacant seats on the SFAB, and those elected and appointed to the NAC and District Committees for terms beginning January 1, 2013.

Questions concerning this Election Notice may be directed to

- Marcia Asquith, Senior Vice President and Corporate Secretary, at (202) 728-8949; or
- Chip Jones, Senior Vice President, Member Relations, at (240) 386-4797.

# Small Firm Advisory Board Election Results

FINRA small firms in the North and West Regions elected the following individuals to fill open seats on the SFAB:

#### **North Region**

John I. (Jack) Fitzgerald Leerink Swann LLC

**West Region** 

Timothy U. Morton WBB Securities, LLC

The FINRA Board also appointed the following individuals as At-Large SFAB Members:

Joseph R.V. Romano Romano Brothers & Co.

Hardeep Walia Motif Investing

These elected and appointed individuals will serve a three-year term beginning January 1, 2013.

#### **December 6, 2012**

#### **Suggested Routing**

- Executive Representative
- Senior Management



# National Adjudicatory Council

The following individual was elected and appointed to fill the Small Firm seat on the NAC for a term beginning January 1, 2013.

Paige W. Pierce RW Smith & Associates, Inc.

Additionally, the Board appointed the following individuals as Non-Industry NAC Members to three year terms beginning on January 1, 2013.

Chris Brummer–Professor Georgetown University Law Center
Onnig Dombalagian–Professor Tulane University School of Law
Cynthia Lewin–General Counsel AARP

#### **District Committees**

The following individuals were elected or appointed to serve on FINRA District committees and will serve three-year terms (unless noted below) beginning January 1, 2013.

#### District 1

Small Firm Representative: Egidio Mogavero, JMP Securities LLC

Large Firm Representative: Janet Epstein, Charles Schwab & Co.

District 2:

Small Firm Representative: Kristina Cole, WBB Securities, LLC

Small Firm Representative: Richard Dahl, Sorrento Pacific Financial, LLC (Two years)

(Vacancy)

Large Firm Representative: Monica Daggs, CUSO Financial Services, LP

District 3:

Small Firm Representative: Gordon A. Price, Walton Securities, Inc.

Large Firm Representative: Mary K. Simonson, SagePoint Financial, Inc.

Vacancy: Richard Moran, Symetra Investment Services (One year)

District 4:

Small Firm Representative: Norman Conley, J.A. Glynn & Co.

Large Firm Representative: Timothy Halevan, CUNA Brokerage Services, Inc.

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District 5:

Small Firm Representative: Kathryn P. Wilson, The Baker Group LP

Large Firm Representative: James F. Dixon III, Sterne, Agee, & Leach Inc.

District 6:

Small Firm Representative: David D. McNally, McNally Financial Services Corporation

Large Firm Representative: Susanne Denby, NFP Securities, Inc.

District 7:

Small Firm Representative: Virginia Voos, Bridge Capital Associates, Inc.

Large Firm Representative: Donald Runkle, Raymond James Financial Services, Inc.

District 8:

Small Firm Representative: Jason M. Welch, WWK Investments, Inc.

Large Firm Representative: Aimee Blinder-Ullrich, National Planning Corporation

**District 9:** 

Small Firm Representative: Allan Goldstein, SJ Levinson & Sons LLC

Large Firm Representative: Gary Johnson, Pershing LLC

District 10:

Small Firm Representative: George Ramirez, MFR Securities, Inc.

Small Firm Representative: David V. Shields, Wellington Shields & Co. LLC

Mid-Size Firm Representative: Robert Moore, Concept Capital Markets LLC

Large Firm Representative: Arlene Klein, RBC Capital Markets, LLC

Large Firm Representative: James Siegel, Royal Alliance Associates, Inc.

Vacancy: Andrew Weinberg, Deutsche Bank (One year)

District 11

Small Firm Representative: Stephen Sussman, Sussman Financial Services, LLC

Large Firm Representative: Dennis Beirne, Peoples Securities

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