

# Notices

## Regulatory Notices

- 14-01** Final Renewal Statements for Broker-Dealers, Investment Adviser Firms, Agents and Investment Adviser Representatives, and Branches; **Payment Deadline: January 10, 2014**
- 14-02** FINRA Requests Comment on Proposed Amendments to FINRA Rule 4210 for Transactions in the TBA Market; **Comment Period Expires: February 26, 2014**
- 14-03** Amendments to FINRA Rule 2251; Effective Date: January 1, 2014
- 14-04** SEC Approves Amendments to FINRA Rules 6271 and 6272 Regarding the Requirements For Firms Seeking Registration as FINRA Alternative Display Facility (ADF) Market Participants; **Effective Date: February 3, 2014**

## Information Notice

- 01/08/14** 2014 Annual Audit, FOCUS, Form Custody, Supplemental Statement of Income (SSOI) and Off-Balance Sheet (OBS) Report Filing Due Dates

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# Regulatory Notice

## 14-01

## BD and IA Renewals for 2014

### Final Renewal Statements for Broker-Dealers, Investment Adviser Firms, Agents and Investment Adviser Representatives, and Branches

Payment Deadline: January 10, 2014

#### Executive Summary

FINRA is issuing this *Notice* to help firms review, reconcile and respond to their Final Renewal Statements as well as view the reports that are currently available in Web CRD/IARD for the annual registration renewal process. The payment deadline is January 10, 2014.

Questions concerning this *Notice* should be directed to the FINRA Call Center at (301) 869-6699.

#### Background & Discussion

##### Final Renewal Statements

On January 2, 2014, Final Renewal Statements and reports became available for viewing and printing in Web CRD/IARD. These statements reflect the final status of broker-dealer, registered representative, investment adviser firm, investment adviser representative, and branch registrations and/or notice filings as of December 31, 2013. Any adjustments in fees owed because of registration terminations, approvals, firm IA registrations, reporting status or notice filings subsequent to the Preliminary Renewal Statement are included in this final reconciled statement.

If the amount assessed on the Final Renewal Statement is greater than the amount assessed on the Preliminary Renewal Statement, the additional renewal fees are due by January 10, 2014. If the amount assessed on the Final Renewal Statement is less than the amount assessed on the Preliminary Renewal Statement, FINRA has issued a credit to the firm's FINRA Flex-Funding Account.

#### January 2014

##### Notice Type

- ▶ Renewals

##### Suggested Routing

- ▶ Compliance
- ▶ Finance
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Registration
- ▶ Senior Management

##### Key Topics

- ▶ IARD™
- ▶ Registration
- ▶ Renewals
- ▶ Web CRD®

##### Referenced Rules & Notices

- ▶ NTM 02-48

The Final Renewal Statements include the following fees (if applicable):

- ▶ Web CRD system processing fees;
- ▶ FINRA branch office and branch processing fees;
- ▶ NYSE MKT LLC (AMEX), BATS Y-Exchange, Inc. (BATS-YX), BATS Z-Exchange, Inc. (BATS-ZX), BOX Options Exchange, LLC (BOX), NASDAQ OMX BX, Inc. (BX), C2 Options Exchange, Incorporated (C2), Chicago Board Options Exchange (CBOE), Chicago Stock Exchange (CHX), EDGA Exchange, Inc. (EDGA), EDGX Exchange, Inc. (EDGX), International Securities Exchange (ISE), ISE GEMINI (GEMINI), NASDAQ Stock Exchange (NOX), National Stock Exchange (NSX), New York Stock Exchange (NYSE), NYSE Arca, Inc. (ARCA), and NASDAQ OMX PHLX, Inc. (PHLX) maintenance fees, if applicable;
- ▶ state broker-dealer firm, branch and agent renewal fees, if applicable;
- ▶ state investment adviser firm, branch and representative renewal fees, if applicable.

FINRA must receive full payment of the Final Renewal Statement fees by January 10, 2014.

## Renewal Payment

Web CRD/IARD issues a refund if a firm has fewer individuals, branch offices or jurisdictions registered or notice filed at year-end than it did on the Preliminary Renewal Statement. Note that FINRA transferred overpayments to firms' Flex-Funding Accounts on January 2, 2014. Firms that have a credit balance in their Flex-Funding Accounts may submit a [refund request](#) to FINRA or leave the funds in their account to pay for other future fees.

If the Final Renewal Statement reflects an amount due, FINRA must receive payment no later than January 10, 2014. Firms have four payment options:

1. FINRA's E-Bill System (replaced Web CRD/IARD E-Pay System)
2. Wire transfer
3. Automatic Flex-Funding Account-to-Renewal Account Transfer; or
4. Check

## Electronic Payment via E-Bill

[E-Bill](#) allows a firm to authorize electronic payment directly from its designated bank account to its Renewal Account. Payments submitted by 8 p.m., Eastern Time (ET), should post within two business days to the firm's Renewal Account. FINRA does not charge for using E-Bill; however, firms should verify if their banks charge additional fees. Firms must enroll to use E-Bill. For your convenience, a hyperlink to E-Bill is on your firm's renewal statement.

## Wire Payment

Firms may wire full payment of their Final Renewal Statements. Firms should provide their banks with the following information:

Transfer funds to: **BNY Mellon Financial, Philadelphia, PA**  
ABA Number: **031000037**  
Beneficiary: **FINRA**  
FINRA Account Number: **8-234-353**  
Reference Number: **Firm CRD number and “Renewal”**

To ensure prompt processing of a renewal payment by wire transfer, remember to:

- ▶ Inform the bank to credit funds to the **FINRA bank account**.
- ▶ Provide the firm’s CRD number and “Renewal” as reference only.
- ▶ Record the confirmation number of the wire transfer provided by the bank.

## Automatic Flex-Funding Account-to-Renewal Account Transfer

If a firm has sufficient funds available in its Flex-Funding Account to cover the total renewal fees due, then FINRA will automatically transfer funds from a firm’s Flex-Funding Account to its Renewal Account beginning on January 13, 2014, until any outstanding renewal assessment is satisfied. **Please Note:** If your firm does not want funds automatically transferred then ensure FINRA receives payment by January 10, 2014, in your firm’s Renewal Account using E-Bill or by wire transfer. Separately, if your firm needs to transfer funds between affiliated firms, you should submit a [Web CRD/IARD Funds Transfer Request form](#).

## Check

All Web CRD/IARD check payments sent to FINRA are deposited into firms’ Flex-Funding Accounts. If you mail a check to pay your firm’s renewal fees, it will not be applied to your Renewal Account until January 13, 2014, when FINRA begins the automatic Flex-Funding Account-to-Renewal Account transfer noted above. For inclusion in the automatic transfer, please ensure that you have sufficient funds in your Flex-Funding Account to cover the total renewal fees due. If you would like your renewal payment to be applied before January 13, 2014, then you must pay using E-Bill or with a wire transfer directly to your Renewal Account.

The check must be drawn on the FINRA-registered firm's account and include the firm's CRD number and "Renewal" in the memo line. Firms paying by check should account for U.S. mail delivery and payment processing time. To ensure prompt processing of checks:

- ▶ Include a print-out of the first page of your Final Renewal Statement with payment.
- ▶ Do not include any other forms or fee submissions.
- ▶ Make the check payable to FINRA and write your firm's CRD number and "Renewal" on the check memo line.

Send payment in the blue, pre-addressed renewal payment envelope mailed to your firm in early November or write the address on an envelope exactly as noted in this *Notice*:

U.S. Mail	Overnight or Express Delivery
<p><b>FINRA</b> P.O. Box 7777-W9995 Philadelphia, PA 19175-9995</p> <p><i>Note: This box will not accept courier or overnight deliveries.</i></p>	<p><b>FINRA</b> Attention: 9995 500 Ross Street 154-0455 Pittsburgh, PA 15262</p> <p>Telephone: (301) 869-6699</p>

If your firm's accounting software (e.g., Quicken, Quickbooks) stores vendor addresses, please ensure it reflects the addresses shown above.

## Renewal Reports

Renewal reports include all individual registrations renewed for 2014; however, they do not include registrations that were "pending approval" or "deficient" at year-end. Firms should examine their reports carefully to ensure that all registration approvals are correct. FINRA also suggests that firms include these reports in firms' permanent records.

- ▶ **Firm Renewal Report:** This report lists all renewed personnel with FINRA and participating regulators. Individuals whose registrations are "approved" with any of these regulators during November and December will be included in this report, while registrations that are still pending or deficient will not be included. Firms should use this report to reconcile their records for renewal purposes.
- ▶ **Branches Renewal Report:** This report lists each branch registered with FINRA and other regulators that renew branches registered with them through Web CRD/IARD for which the firm was assessed a fee. Firms should use this report to reconcile their records for renewal purposes.

## Discrepancies

If a firm finds any discrepancies between its records and those maintained on Web CRD/IARD, the firm must report the discrepancy to FINRA. Firms must report all discrepancies by January 10, 2014. Copies of appropriate documentation from the firm's Web CRD/IARD queues, such as a Web CRD-generated notice of termination, notification of deficient condition or notice of approval, should be readily available upon request by FINRA. Documentation should be mailed to:

FINRA  
Registration Management  
9509 Key West Ave  
Rockville, MD 20850

The Renewal Program Bulletin contains detailed instructions to help firms complete the renewal process. This publication is available at [www.finra.org/renewals](http://www.finra.org/renewals).

## Margin Requirements

### FINRA Requests Comment on Proposed Amendments to FINRA Rule 4210 for Transactions in the TBA Market

Comment Period Expires: February 26, 2014

#### Executive Summary

FINRA is seeking comment on proposed amendments to FINRA Rule 4210 to establish margin requirements for transactions in the To Be Announced (TBA) market.<sup>1</sup> The proposal, designed to reflect the growth of the TBA market and to replace current interpretive materials under Rule 4210 that have become outdated, is informed by the set of best practices adopted by the Treasury Market Practices Group (TMPG) of the Federal Reserve Bank of New York (FRBNY). Consistent with the overarching goal of many regulatory initiatives since the financial crisis, the proposal aims to reduce counterparty credit risk. The proposal would accomplish this in the TBA market by addressing, among other things, maintenance margin and variation (also referred to in the proposed rule language and this *Notice* as mark to market) margin requirements, risk limit determinations, concentrated exposures, and exemptions for de minimis transfer amounts and for transactions cleared through registered clearing agencies. The proposed rule amendment is available as Attachment A at [www.finra.org/notices/14-02](http://www.finra.org/notices/14-02).

Questions regarding this *Notice* should be directed to:

- ▶ Glen Garofalo, Director, Credit Regulation, at (646) 315-8464;
- ▶ Peter Tennyson, Director, Broker-Dealer Operations and Financial Responsibility, at (646) 315-8403;
- ▶ Adam H. Arkel, Associate General Counsel, Office of General Counsel, at (202) 728-6961.

January 2014

#### Notice Type

- ▶ Request for Comment

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Margin Department
- ▶ Operations
- ▶ Regulatory Reporting
- ▶ Risk Management
- ▶ Senior Management

#### Key Topics

- ▶ Agency Mortgage-Backed Securities
- ▶ Margin
- ▶ TBA Market

#### Referenced Rules & Notices

- ▶ FINRA Rule 4210
- ▶ FINRA Rule 6710
- ▶ NTM 03-73
- ▶ SEA Rule 15c3-1

## Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by February 26, 2014.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to [pubcom@finra.org](mailto:pubcom@finra.org); or
- ▶ Mailing comments in hard copy to:  
Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

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

**Important Notes:** All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.<sup>2</sup>

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be filed with the SEC pursuant to SEA Section 19(b).<sup>3</sup>

## Background & Discussion

Most trading of agency mortgage-backed securities (MBS) takes place in what is generally referred to by industry participants as the TBA market, which is characterized by transactions with forward settlements as long as six months past the trade date.<sup>4</sup> Agency MBS is one of the largest fixed income markets, with \$5 trillion of securities outstanding and approximately \$750 billion to \$1.5 trillion in gross unsettled and unmargined dealer to customer transactions.<sup>5</sup>

Historically, the TBA market is one of the few markets where the exchange of margin has not been a common practice, thereby creating a potential risk from the counterparty exposure. Futures markets, for example, require the daily posting of both initial and maintenance margin and variation margin on all exchange cleared contracts. Market convention has been to exchange margin in the repo and securities lending markets, even when the collateral consists of exempt securities. The FRBNY recognized the existence of this gap and charged the TMPG with establishing standards regarding the margining of forward-settling agency MBS transactions. The TMPG has noted:

To the extent that they remain unmargined, uncleared agency MBS transactions can pose significant counterparty risk to individual market participants. Moreover, the market's sheer size . . . raises systemic concerns. If one or more market participants were to default on forward-settling agency MBS trades, the agency MBS market could transmit losses and risks to a broad array of other participants. While the transmission of these risks may be mitigated by the netting, margining, and settlement guarantees provided by a [central counterparty], losses could nonetheless be costly and destabilizing. Furthermore, the asymmetry that exists between participants that margin and those that do not could have a negative effect on liquidity, especially in times of market stress.<sup>6</sup>

The best practices the TMPG<sup>7</sup> adopted are only recommendations—they are not requirements.<sup>8</sup> Unsecured credit exposures that exist in the TBA market today can lead to financial losses by members. Permitting counterparties to participate in the TBA market without posting margin can facilitate increased leverage by customers, thereby potentially posing a risk to the member extending credit and to the marketplace as a whole. Further, FINRA's current interpretive guidance<sup>9</sup> for the TBA market has not been updated since the financial crisis. In view of the growth in volume in the TBA market, the number of participants and the credit concerns that have been raised in recent years, FINRA believes there is a need to establish FINRA rule requirements that will extend responsible practices to all members that participate in this market.

Accordingly, FINRA is seeking comment on proposed amendments to FINRA Rule 4210 to establish margin requirements for the TBA market. Specifically, the proposed rule change applies to TBA transactions (inclusive of ARM transactions), Specified Pool Transactions, and transactions in CMOs, with forward settlement dates (for purposes of the proposed amendments, these are defined below collectively as Covered Agency Securities—for simplicity, throughout this *Notice* the terms "Covered Agency Securities" and "TBA market" are used interchangeably). The proposed rule change is informed by the TMPG best practices. Further, the scope of products the proposed amendments cover is intended to be congruent with those covered by the TMPG best practices, including updated guidance that the TMPG has released since the TMPG issued the original best practices.<sup>10</sup>

### Summary of Proposed Amendments

Broadly, the proposed rule change provides that all members would be required to collect variation margin for transactions in Covered Agency Securities when the current exposure exceeds \$250,000. In addition, members would be required to collect maintenance margin for transactions with non-exempt counterparties (as discussed further below). A summary of the key aspects of the proposed amendments follows:

- ▶ **Definition of "Covered Agency Securities":** As noted earlier, the proposed amendments apply to "Covered Agency Securities," the scope of which is designed to be congruent with the products covered by the TMPG best practices. The term is defined to include:

- ▶ TBA transactions, as defined in Rule 6710(u),<sup>11</sup> for which the difference between the trade date and contractual settlement date is greater than one business day, inclusive of ARM transactions;
  - ▶ Specified Pool Transactions, as defined in Rule 6710(x),<sup>12</sup> for which the difference between the trade date and contractual settlement date is greater than one business day; and
  - ▶ transactions in CMOs, as defined in Rule 6710(dd),<sup>13</sup> issued in conformity with a program of an Agency, for which the difference between the trade date and contractual settlement date is greater than three business days.
- ▶ **Risk Limits:** Informed by current interpretations of FINRA rules, members that engage in Covered Agency Security transactions with any counterparty<sup>14</sup> will be required under the proposal to make a determination in writing of a risk limit to be applied to each such counterparty.<sup>15</sup> The proposal further requires that the risk limit determination must be made by a credit risk officer or credit risk committee in accordance with the member's written risk policies and procedures.<sup>16</sup> The proposal permits members of limited size and resources that do not have a credit risk officer or credit risk committee to designate an appropriately registered principal to make the risk limit determinations.
- ▶ **Registered Clearing Agencies:** Transactions cleared through a registered clearing agency, and subject to the margin requirements of that clearing agency, will not be subject to the proposed requirements.
- ▶ **Transactions with Exempt Counterparties:** For purposes of the proposed amendments, an exempt counterparty is an "exempt account" as that term is defined under Rule 4210(a)(13).<sup>17</sup> The proposal provides that for transactions with exempt counterparties, maintenance margin will not be required. However, such transactions must be marked to the market daily and the member must collect any loss resulting from such marking to market (*i.e.*, members must collect variation margin, which is consistent with the approach taken by the TMPG best practices and includes the posting of margin between all counterparties, including broker-dealers).<sup>18</sup> The proposal provides that the amount of any uncollected mark to market loss must be deducted in computing the member's net capital as provided in SEA Rule 15c3-1 at the close of business following the business day the mark to market loss was created. Further, if variation margin is not posted to secure the mark to market loss within five business days from the date the loss was created, the member is required to promptly take liquidating action, unless FINRA grants the member an extension. This differs from FINRA's current interpretation to Rule 4210 that permits members to only take a charge to net capital in lieu of collecting the mark to market loss from exempt accounts.<sup>19</sup> The proposal provides that members may treat mortgage bankers<sup>20</sup> that use Covered Agency Securities to hedge their pipeline of mortgage commitments as exempt accounts.<sup>21</sup>

- ▶ **Transactions With Non-Exempt Accounts:** The proposal provides that for transactions with non-exempt accounts, members must collect variation margin and must collect maintenance margin equal to 2 percent of the market value of the securities. FINRA notes that the maintenance margin requirement of 2 percent would include mortgage banker transactions that exceed the hedge necessary to cover the mortgage pipeline, as well as speculative transactions. To the extent such margin is not collected, the member will be required to deduct such amount from the member's net capital as provided in SEA Rule 15c3-1 at the close of business following the business day the deficiency was created. Further, if such required margin is not collected within five business days, the member must take liquidating action. This differs from the current interpretations to Rule 4210, which impose a 5 percent margin requirement plus any mark to market loss for any non-exempt accounts.<sup>22</sup>
- ▶ **De Minimis Transfer:** Recognizing the potential operational burden of collecting margin and consistent with other OTC derivatives markets, FINRA proposes to provide for a minimum transfer amount of \$250,000 (the "*de minimis* transfer amount") below which the member need not collect margin (provided the member deducts the amount outstanding in computing net capital as provided in SEA Rule 15c3-1 at the close of business the following business day).
- ▶ **Concentrated Exposures:** The proposal establishes a new reporting obligation with respect to concentrated credit exposures. Specifically, a member would have a written notification requirement to FINRA and would be prohibited from entering into any new transactions that could increase credit exposure if net capital deductions, over a five business day period, exceed:
  - ▶ **for a single account or group of commonly controlled accounts:** 5 percent of the member's tentative net capital; or
  - ▶ **for all accounts combined:** 25 percent of the member's tentative net capital.
- ▶ **Determination of Exempt Account:** The proposal clarifies that the determination of whether an account meets the definition of exempt account must be based upon the beneficial ownership of the account. The proposal provides that sub-accounts managed by an investment adviser (where the beneficial owner is other than the investment adviser) must be margined individually. Members that do not already operate in this way will need to conform their practice accordingly.
- ▶ **Central Banks:** The proposal will not apply to transactions with central banks.<sup>23</sup>

### Request for Comment

FINRA is requesting comment on all aspects of the proposal, including costs and burdens that the proposal could impose. In particular, FINRA seeks comment on the following issues:

- ▶ **Market Participants and Consistency With Other Regulatory Regimes:** FINRA believes that instituting mark to market and maintenance margin requirements is consistent with regulatory regimes in other markets, such as the futures and other contract markets, where participants are subject to daily mark to market and initial margin. TBA market participants include FINRA members,<sup>24</sup> banks, hedge funds, mutual funds, mortgage bankers and other institutional customers. FINRA believes that there are few retail customers that participate directly in this market. Many of the members and counterparties that participate in this market will collect variation margin in the TBA market in conformance with the TMPG best practices. What types of market participants will be impacted by these proposals? Will these rules have a direct and measureable impact on retail customers? If so, what are they?
- ▶ **Impact on Market Participants:** In developing the proposal, FINRA staff has engaged in conversations with various industry participants, including firms of varying sizes. While FINRA believes that the proposed rule change will reduce systemic risk, it may impact market participants in a number of ways:
  - ▶ First, will FINRA's imposition of mandatory margin requirements negatively impact the liquidity and pricing in this market? If so, in what ways?
  - ▶ Second, the posting of margin will require additional liquidity on the part of market participants. Larger dealers will likely not be significantly impacted by the additional liquidity needs resulting from posting variation margin. However, mid-size and smaller dealers may be presented with liquidity constraints as a result of the need to post variation margin to a counterparty without the ability to collect from another counterparty when one side of their transaction is cleared through Mortgage-Backed Securities Clearing Corporation and the other side is bilateral. In addition, non-exempt customers may also face liquidity constraints in posting both variation and maintenance margin and may choose to limit their participation in the TBA market as a result. What would be the extent of these liquidity constraints? How will this impact market liquidity and pricing? How will different firms (*e.g.*, different sizes or different business models) be impacted?
  - ▶ Third, because not all dealers in the TBA market are FINRA members, what is the potential that the proposal will result in a shift of the market to bank dealers that are non-FINRA participants? Are there other impacts on FINRA members versus non-FINRA members that FINRA should consider?
  - ▶ Fourth, to what extent will the reduced leverage of a counterparty impact market liquidity and pricing? What are the potential impacts on consumers in the mortgage market?

- ▶ Fifth, with respect to certain market participants, dealers and institutional customers alike, operational costs are likely to be incurred in developing the necessary compliance infrastructure. What would be the extent of these costs, both initially and for ongoing compliance?
- ▶ Sixth, FINRA believes that there are approximately 30 non-clearing firms that participate in the TBA market. These firms are likely to incur additional costs from their clearing firms to establish margin practices that they may not have needed in the past. Such firms may choose to self-clear transactions, which may increase the operational risk at these firms as well as add to their cost of doing business. What would be the extent of these costs?
- ▶ Seventh, there are operational costs that firms will face with respect to the handling of collateral for investment adviser accounts. What costs would be incurred and what would be the extent of these costs?
- ▶ **Non-Exempt Accounts:** In developing the proposal, FINRA considered the appropriateness of applying maintenance margin requirements to non-exempt accounts. FINRA believes that doing so would be consistent with the proposal's purpose of reducing risk as non-exempt accounts may not have sufficient financial resources to absorb losses. As such, continuing to allow them to enter into TBA market transactions without posting maintenance margin would expose the broker-dealer and the market to greater risk. However, requiring maintenance margin may result in fewer non-exempt accounts participating in the TBA markets. Should FINRA reconsider the proposal's approach to non-exempt accounts? If so, why? What will be the impact to the market of requiring maintenance margin for non-exempt accounts? What would be the extent of any possible reduction in participation by non-exempt accounts? Do non-exempt accounts pose greater credit risk to market participants because of their smaller size and resources?
- ▶ **Mortgage Bankers:** FINRA believes that the proposal permits sufficient flexibility for mortgage bankers to continue to use Covered Agency Securities as a hedge to mortgage originations, while also addressing the low capital and liquidity that many mortgage bankers maintain. What is the impact of requiring mortgage bankers to post variation margin? Will this requirement lead to a change in behavior such that mortgage bankers choose not to participate in the TBA market? If so, what will the impact be? How will members ascertain that mortgage banker transactions are actually hedging transactions?
- ▶ **Eligible Collateral:** FINRA believes that all margin eligible securities, with the appropriate margin requirement, should be permitted as collateral to satisfy required margin. This would expand the current market convention of posting cash or U.S. Treasuries to include corporate and equity securities. Pursuant to FINRA Rule 4210, equity securities would receive 75 percent margin value. FINRA is seeking comment as to whether the expanded set of collateral is appropriate.

- ▶ **Close-out Requirements:** As noted earlier, the proposal requires the close out of transactions if a margin call has not been met within five business days. FINRA is soliciting comment on whether this timeframe is appropriate. Further, the rule permits an extension of time to be granted for the close out. What would be the anticipated impact of the close-out requirement as proposed? What factors should be considered in determining whether or not an extension is appropriate?
- ▶ **Collection of Call:** The proposal requires a margin call to be met by the close of business the following day. After that date, the member must take a charge to its net capital of the under-margined amount. What would be the anticipated impact of the collection of call requirement as proposed? Are there instances where this timeframe is too short and an extended timeframe should be considered?
- ▶ **Risk Limit Determinations:** The proposal requires that members that engage in TBA market transactions with any counterparty must make a determination in writing of a risk limit to be applied to each such counterparty. The risk limit determination must be made by a credit risk officer or credit risk committee in accordance with the member's written risk policies and procedures. The proposal further provides that members of limited size and resources that do not have a credit risk officer or credit risk committee may designate an appropriately registered principal to make the risk limit determinations. What would be the anticipated impact of the risk limit determination as proposed? Is this appropriate? Why? If not, why not?
- ▶ **De Minimis Transfer Amount:** As noted earlier, the proposal establishes a \$250,000 *de minimis* transfer amount. What would be the anticipated impact of the *de minimis* transfer amount as proposed? Is this amount appropriate? If not, why not, and what should the amount be and why?
- ▶ **Effective Date:** Recognizing the operational and technology challenges, what is the appropriate amount of time needed to implement these changes? Is a six month period adequate or should a longer period of time be considered? What factors should be considered in determining whether an extension is appropriate?
- ▶ **Other:** Are there any other concerns that should be addressed?

## Endnotes

1. For simplicity, throughout this *Notice* the term TBA market is used to refer to TBA transactions (inclusive of adjustable rate mortgage (ARM) transactions), Specified Pool Transactions, and transactions in Collateralized Mortgage Obligations (CMOs), with forward settlement dates. As further discussed in this *Notice*, the proposal defines these transactions as Covered Agency Securities.
2. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *NTM 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
3. See SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
4. See, e.g., the SEC's [Staff Report of the Task Force on Mortgage-Backed Securities Disclosure](#).
5. See Report of the TMPG, [Margining in Agency MBS Trading](#) (November 2012) (referred to as the "TMPG Report"). The TMPG is a group of market professionals that participate in the TBA market and is sponsored by the FRBNY.
6. See the TMPG Report.
7. See [Best Practices for Treasury, Agency Debt, and Agency Mortgage-Backed Securities Markets](#).
8. Absent the establishment of a rule requirement, the TMPG best practices could become more widely adopted over time by other market participants. However, this will take time and in the interim would leave firms at risk.
9. See Interpretations /01 through /08 of FINRA Rule 4210(e)(2)(F). Such guidance references TBAs largely in the context of Government National Mortgage Association (GNMA) securities. The modern TBA market is much broader than GNMA securities.
10. See, e.g., [TMPG Releases Updates to Agency MBS Margining Recommendation](#) (March 2013).
11. FINRA Rule 6710(u) defines "TBA" to mean a transaction in an Agency Pass-Through Mortgage-Backed Security or an SBA-Backed ABS where the parties agree that the seller will deliver to the buyer a pool or pools of a specified face amount and meeting certain other criteria but the specific pool or pools to be delivered at settlement is not specified at the time of execution, and includes TBA transactions "for good delivery" and TBA transactions "not for good delivery." FINRA Rule 6710(v) defines "Agency Pass-Through Mortgage-Backed Security" as a type of Asset-Backed Security issued in conformity with a program of an Agency or a government-sponsored enterprise (GSE), for which the timely payment of principal and interest is guaranteed by the Agency or GSE, representing ownership interest in a pool(s) of mortgage loans structured to "pass through" the principal and interest payments to the holders of the security on a pro rata basis. FINRA Rule 6710(bb) defines SBA-Backed ABS similarly, though with reference to Asset-Backed Securities issued in conformity with a program of the Small Business Administration. FINRA Rule 6710(m) defines "Asset-Backed Security" to include, in part, a security collateralized by any type of financial asset, such as a loan, lease, mortgage, or a secured or unsecured receivable. Lastly, the term "Agency" is defined under FINRA Rule 6710(k).

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12. Rule 6710(x) defines Specified Pool Transaction to mean a transaction in an Agency Pass-Through Mortgage-Backed Security or an SBA-Backed ABS requiring the delivery at settlement of a pool(s) that is identified by a unique pool identification number at the time of execution.
13. FINRA has filed paragraph (dd) of FINRA Rule 6710 for approval by the SEC. See SR-FINRA-2013-046. The rule will define CMO to mean a type of Securitized Product structured in multiple classes (or tranches) backed by Agency Pass-Through Mortgage-Backed Securities, mortgage loans, certificates backed by project loans or construction loans, other types of mortgage-backed securities or assets derivative of mortgage-backed securities, and includes a real estate mortgage investment conduit (REMIC) and an Agency-Backed Commercial Mortgage-Backed Security as defined in FINRA Rule 6710(ee) (which, like Rule 6710(dd), the staff has filed for approval by the SEC).
14. Under the proposal, a “counterparty” is defined as any person that enters into a Covered Agency Security transaction with a member and includes a “customer” as defined in paragraph (a)(3) of FINRA Rule 4210.
15. See Interpretation /03 of FINRA Rule 4210(e)(2)(F). Under the current interpretation, the risk limit determination is an alternative available to alleviate otherwise required net capital deductions or margin requirements, as applicable. FINRA notes that, as a matter of practice, most members have availed themselves of this relief and have applied risk limit determinations to TBA transactions in general. (To recap, Interpretation /03 of FINRA Rule 4210(e)(2)(F) provides that, in lieu of deducting from capital 100 percent of any marked to the market losses in exempt accounts and having to obtain margin as well as any marked to the market losses from non-exempt mortgage bankers’ accounts, members may make a determination in writing of a risk limit for each such exempt account and non-exempt mortgage banker’s account.)
16. FINRA believes that this requirement extends logically from the SEC’s new Rule 17a-3(a)(23), which, in part, requires a broker-dealer with specified amounts of aggregate credit items or capital to document the “credit, market, and liquidity risk management controls established and maintained by the broker or dealer to assist it in analyzing and managing the risks associated with its business activities . . .” See Exchange Act Release No. 70072 (July 30, 2013), 78 FR 51824 (August 21, 2013) (Financial Responsibility Rules for Broker-Dealers).
17. Broadly speaking, exempt accounts include FINRA members, non-member registered broker-dealers, “designated accounts” under FINRA Rule 4210(a)(4) (including banks, savings associations, insurance companies, investment companies, states or subdivisions, or pension plans), and persons meeting specified net worth requirements and other conditions.
18. FINRA staff has consulted with the SEC staff concerning the net capital treatment of variation margin posted by a broker-dealer with a counterparty. It is anticipated that the SEC will issue guidance, such that if certain conditions are met, the resulting receivables can be treated as an allowable asset in computing net capital.
19. See Interpretation /04 of FINRA Rule 4210(e)(2)(F).

20. The proposal defines a “mortgage banker” as an entity, however organized, that engages in the business of providing real estate financing collateralized by liens on such real estate. FINRA notes that the definition is meant to include for example banks and credit unions, to the extent they originate mortgages.
21. This means that mortgage bankers must post variation margin and may need to post maintenance margin. Under FINRA’s current interpretation, mortgage bankers with more than \$1.5 million of net worth are not required to post variation or maintenance margin, within risk limits established by the member. *See Interpretation /02 of FINRA Rule 4210(e)(2)(F).*
22. *See Exhibit I to Interpretations to FINRA Rule 4210(e)(2)(F).* Note however that under the current interpretations transactions with delivery dates or contract maturity dates of 120 days or less from trade date do not currently require variation or maintenance margin, though any mark to market loss must be deducted from net capital. Further, FINRA currently allows five business days for the call to be met, before a capital charge is incurred. *See Interpretation /05 of FINRA Rule 4210(e)(2)(F).*
23. For purposes of the proposed rule change, FINRA would interpret “central bank” to include, in addition to government central banks and central banking authorities, sovereigns, multilateral development banks and the Bank for International Settlements. This approach is consistent with the approach taken in the standards established by the Basel Committee on Banking Supervision (BCBS) and the Board of the International Organization of Securities Commissions (IOSCO). *See [BCBS and IOSCO Margin Requirements for Non-Centrally Cleared Derivatives](#).*
24. FINRA staff’s review of the off balance sheet schedule that was filed as of June 30, 2013, by all carrying and clearing members identified 47 members that reported TBA balances as of that date. A review of TRACE data for the one year period October 2012 through September 2013 showed a daily average number of transactions in Covered Agency Securities of 8,276 with an average total daily dollar volume of \$192 billion. One hundred sixty-four member members reported good delivery TBA transactions during this period. The category of securities with the largest number of members reporting, at 543, is agency CMOs with a settlement date greater than three business days from trade date, where there was a daily average number of trades reported of 181 during this one year period with an average original face amount of \$1,992,000.

## Proxy Rate Reimbursement and Enhanced Brokers' Internet Platforms

### Amendments to FINRA Rule 2251

Effective Date: January 1, 2014

#### Executive Summary

Effective January 1, 2014, FINRA has amended the provisions of FINRA Rule 2251 regarding rates of reimbursement for expenses incurred in processing and forwarding of proxy and other issuer-related materials. The rule change also establishes a specified success fee for the development of qualified Internet platforms for proxy voting purposes (the Enhanced Brokers' Internet Platform or EBIP). The rule change conforms to provisions the Securities and Exchange Commission (SEC) has approved and the New York Stock Exchange (NYSE) has already adopted.

As discussed further in this *Notice*, the rule change requires that any FINRA member firm that is not also a member of the NYSE with a qualifying EBIP must provide notice to FINRA.<sup>1</sup>

The text of the rule change is available as Attachment A at [www.finra.org/notices/14-03](http://www.finra.org/notices/14-03). A summary chart that matches the new FINRA rule provisions with the corresponding NYSE rule provisions appears at the end of this *Notice*.

Questions regarding this *Notice*, other than EBIP notifications, should be directed to Adam H. Arkel, Associate General Counsel, Office of General Counsel, at (202) 728-6961.

Firms should direct EBIP notifications, and questions related to such notifications, to their Regulatory Coordinator.

#### January 2014

##### Notice Type

- ▶ Rule Amendment

##### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Senior Management

##### Key Topics

- ▶ Enhanced Brokers' Internet Platform
- ▶ Proxy Rate Reimbursement

##### Referenced Rules & Notices

- ▶ FINRA Rule 2251
- ▶ NYSE Information Memo 14-03
- ▶ NYSE Rule 451.90
- ▶ NYSE Rule 451.92
- ▶ SEA Rule 14b-1
- ▶ SEA Rule 14b-2

## Background & Discussion

FINRA Rule 2251 requires FINRA member firms to transmit proxy materials and other communications to beneficial owners of securities and limits the circumstances in which FINRA member firms may vote proxies without instructions from those beneficial owners.<sup>2</sup> The rule also sets forth the rate reimbursement provisions pursuant to which firms are entitled to receive fees in connection with the rule's forwarding obligations.

On October 18, 2013, the SEC approved a proposed rule change by the NYSE<sup>3</sup> to amend its proxy rate reimbursement rules and to establish a specified success fee for the development of qualified EBIPs. Consistent with the NYSE action, FINRA filed, for immediate effectiveness, a rule change to conform FINRA Rule 2251 to the proxy rate reimbursement rules adopted by the NYSE, including the provisions with respect to EBIPs (specifically, NYSE Rules 451.90 and 451.92).<sup>4</sup> The rule change became effective January 1, 2014.

The new provisions under FINRA Rule 2251 correspond, in virtually identical language, to the NYSE's new provisions under NYSE Rules 451.90 and 451.92. For reference, the summary chart at the end of this *Notice* matches the new FINRA provisions with the corresponding new NYSE provisions. A summary of the new rate reimbursement and EBIP provisions follows below.

- ▶ **Processing Unit Fees:** New FINRA Rule 2251.01(a)(1)(B) establishes, for each set of proxy material, *i.e.*, proxy statement, form of proxy and annual report when processed as a unit, a Processing Unit Fee based on the following schedule according to the number of nominee<sup>5</sup> accounts through which the issuer's securities are beneficially owned:
  - ▶ 50 cents for each account up to 10,000 accounts;
  - ▶ 47 cents for each account above 10,000 accounts, up to 100,000 accounts;
  - ▶ 39 cents for each account above 100,000 accounts, up to 300,000 accounts;
  - ▶ 34 cents for each account above 300,000 accounts, up to 500,000 accounts;
  - ▶ 32 cents for each account above 500,000 accounts.

The new rule provides that, under the above schedule, a firm may charge the issuer the tier one rate for the first 10,000 accounts, or portion thereof, with decreasing rates applicable only on additional accounts in the additional tiers. The rule provides that references to the number of accounts means the number of accounts holding securities of the issuer at any nominee that is providing distribution services without the services of an intermediary, or when an intermediary<sup>6</sup> is involved, the aggregate number of nominee accounts with beneficial ownership in the issuer served by the intermediary. Further, the rule provides that, in the case of a meeting for which an opposition proxy has been furnished to security holders, the Processing Unit Fee shall be \$1.00 per account, in lieu of the fees in the above schedule.

- ▶ **Intermediaries:** New FINRA Rule 2251.01(a)(1)(C) establishes the following supplemental fees for intermediaries:
  - ▶ \$22.00 for each nominee served by the intermediary that has at least one account beneficially owning shares in the issuer;
  - ▶ an Intermediary Unit Fee for each set of proxy material, based on the following schedule according to the number of nominee accounts through which the issuer's securities are beneficially owned:
    - 14 cents for each account up to 10,000 accounts;
    - 13 cents for each account above 10,000 accounts, up to 100,000 accounts;
    - 11 cents for each account above 100,000 accounts, up to 300,000 accounts;
    - 9 cents for each account above 300,000 accounts, up to 500,000 accounts;
    - 7 cents for each account above 500,000 accounts.

The new rule provides that, under the above schedule, a firm may charge the issuer the tier one rate for the first 10,000 accounts, or portion thereof, with decreasing rates applicable only on additional accounts in the additional tiers. For special meetings, the rule provides that the Intermediary Unit Fee shall be based on the following schedule, in lieu of the fees described in the schedule above:

- 19 cents for each account up to 10,000 accounts;
- 18 cents for each account above 10,000 accounts, up to 100,000 accounts;
- 16 cents for each account above 100,000 accounts, up to 300,000 accounts;
- 14 cents for each account above 300,000 accounts, up to 500,000 accounts;
- 12 cents for each account above 500,000 accounts.

The new rule provides that, under the above schedule, a firm may charge the issuer the tier one rate for the first 10,000 accounts, or portion thereof, with decreasing rates applicable only on additional accounts in the additional tiers. For purposes of the rule, a special meeting is a meeting other than the issuer's meeting for the election of directors. Further, the rule provides that, in the case of a meeting for which an opposition proxy has been furnished to security holders, the Intermediary Unit Fee shall be 25 cents per account, with a minimum fee of \$5,000 per soliciting entity, in lieu of the fees described in the two schedules given above, as the case may be. Where there are separate solicitations by management and an opponent, the opponent is to be separately billed for the costs of its solicitation.

- ▶ **Proxy Follow-up Material:** The rule change revises FINRA Rule 2251.01(a)(2) to establish, for each set of proxy follow-up material, a Processing Unit Fee of 40 cents per account, except for those relating to an issuer's annual meeting for the election of directors, for which the Processing Unit Fee shall be 20 cents per account.
- ▶ **Beneficial Ownership Information:** FINRA Rule 2251.01(a)(3) establishes a rate of six and one-half cents per name of non-objecting beneficial owner (NOBO) provided to the issuer pursuant to the issuer's request. Under the rule change, Rule 2251.01(a)(3) is revised to provide that, where the non-objecting beneficial ownership information is not furnished directly to the issuer by the firm, but is furnished through an agent designated by the firm, the issuer will be expected to pay in addition the following fee to the agent, with a minimum fee of \$100 per requested list:
  - ▶ 10 cents per name for the first 10,000 names or portion thereof;
  - ▶ 5 cents per name for additional names up to 100,000 names; and
  - ▶ 4 cents per name above 100,000.

The new rule provides that any firm that designates an agent for the purpose of furnishing requesting issuers with beneficial ownership information pursuant to SEA Rule 14b-1(c) and thereafter cancels that designation or appoints a new agent for such purpose should promptly inform interested issuers. As revised by the rule change, the rule further provides that, when an issuer requests beneficial ownership information as of a date which is the record date for an annual or special meeting or a solicitation of written shareholder consent, the issuer may ask to eliminate names holding more or less than a specified number of shares, or names of shareholders that have already voted, and the issuer may not be charged a fee for the NOBO names so eliminated. In all other cases the issuer may be charged for all the names in the NOBO list.

- ▶ **Interim Report, Post Meeting Report and Other Material:** The rule change revises FINRA Rule 2251.01(a)(4) to establish for interim reports, annual reports if processed separately, post meeting reports, or other material, a Processing Unit Fee of 15 cents per account.
- ▶ **Preference Management Fees:** The rule change establishes a new Preference Management Fee that replaces the "Incentive Fees" provisions under FINRA Rule 2251.01(a)(5). Specifically, the new rule establishes, with respect to each account for which the nominee has eliminated the need to send materials in paper format through the mails (or by courier service), a Preference Management Fee in the following amount:
  - ▶ 32 cents for each set of proxy material described in new FINRA Rule 2251.01(a)(1) (B); provided, however, that if the account is a Managed Account (as defined in new FINRA Rule 2251.01(a)(7), below), the Preference Management Fee shall be 16 cents.
  - ▶ 10 cents for each set of material described in either FINRA Rule 2251.01(a)(2) or (a)(4), as discussed above.

The new rule provides that the Preference Management Fee is in addition to, and not in lieu of, the other fees set forth under FINRA Rule 2251.01.

- ▶ **Notice and Access Fees:** New FINRA Rule 2251.01(a)(6) provides that, when an issuer elects to utilize Notice and Access for a proxy distribution, there is an incremental fee based on all nominee accounts through which the issuer's securities are beneficially owned as follows:
  - ▶ 25 cents for each account up to 10,000 accounts;
  - ▶ 20 cents for each account over 10,000 accounts, up to 100,000 accounts;
  - ▶ 15 cents for each account over 100,000 accounts, up to 200,000 accounts;
  - ▶ 10 cents for each account over 200,000 accounts, up to 500,000 accounts;
  - ▶ 5 cents for each account over 500,000 accounts.

The new rule provides that, under the above schedule, a firm may charge the issuer the tier one rate for the first 10,000 accounts, or portion thereof, with decreasing rates applicable only on additional accounts in the additional tiers. The rule further provides that follow up notices will not incur an incremental fee for Notice and Access. In addition, no incremental fee will be imposed for fulfillment transactions (*i.e.*, a full package sent to a notice recipient at the recipient's request), although out of pocket costs such as postage will be passed on as in ordinary distributions.

- ▶ **Managed Accounts:** New FINRA Rule 2251.01(a)(7) provides that, notwithstanding any other provision under the rule, no fee shall be imposed for a nominee account that is a Managed Account and contains five or fewer shares or units of the security involved. The rule defines "Managed Account" to mean an account at a nominee which is invested in a portfolio of securities selected by a professional adviser, and for which the account holder is charged a separate asset-based fee for a range of services which may include ongoing advice, custody and execution services. The adviser can be either employed by or affiliated with the nominee, or a separate investment advisor contracted for the purpose of selecting investment portfolios for the managed account. Requiring that investments or changes to the account be approved by the client shall not preclude an account from being a "Managed Account," nor shall the fact that commissions or transaction-based charges are imposed in addition to the asset-based fee. New FINRA Rule 2251.01(a)(7) further provides that, notwithstanding any other provision under the rule, no fee shall be imposed for any nominee account which contains only a fractional share, *i.e.*, less than one share or unit of the security involved.
- ▶ **EBIPs:** New FINRA Rule 2251.01(a)(8) provides that, during the period ending December 31, 2018, there shall be a supplemental fee of 99 cents for each new account that elects, and each full package recipient among a brokerage firm's accounts that converts to, electronic delivery while having access to an EBIP. The rule provides that this fee does not apply to electronic delivery consents captured by issuers (for example, through

an open-enrollment program), nor to positions held in Managed Accounts (as defined in FINRA Rule 2251.01(a)(7)) nor to accounts voted by investment managers using electronic voting platforms.<sup>7</sup> The rule provides that this is a one-time fee, meaning that an issuer may be billed this fee by a particular firm only once for each account covered by this rule. Further, billing for this fee should be separately indicated on the issuer's invoice and must await the next proxy or consent solicitation by the issuer that follows the triggering election of electronic delivery by an eligible account. Accounts receiving a notice pursuant to the use of notice and access by the issuer, and accounts to which mailing is suppressed by householding, will not trigger the fee under the rule change. The new rule further provides:

- ▶ To qualify under the rule, an EBIP must provide notices of upcoming corporate votes (including record and shareholder meeting dates) and the ability to access proxy materials and a voting instruction form, and cast the vote, through the investor's account page on the member firm's website without an additional log-in.
- ▶ Any firm that is not also a member of the NYSE with a qualifying EBIP must provide notice thereof to FINRA.<sup>8</sup> Firms must provide such notification, either in hard copy or electronically, to their Regulatory Coordinator. The written notification must include:<sup>9</sup>
  - firm name;
  - firm CRD number;
  - intermediary (if one is used), including any intermediary identification/customer number or code;
  - date the EBIP became operational (for EBIPs already in operation on January 1, 2014, the firm may indicate January 1, 2014, as the date); and,
  - specific description of any limitations on the availability of the EBIP to the firm's customers (e.g., if the EBIP is available only to a certain segment of the firm's customers).

FINRA is considering alternative methods of notification, such as through Firm Gateway, and will announce any changes to the notification procedures in a future *Regulatory Notice*.

- ▶ Conversions to electronic delivery by accounts with access to an EBIP need to be tracked for the purpose of reporting the activity to FINRA when requested, as do records of marketing efforts to encourage account holders to use the EBIP. In addition, records need to be maintained and reported to FINRA when requested regarding the proportion of non-institutional accounts that vote proxies after being provided access to an EBIP.

The guidance applicable to the new NYSE proxy rate rules as set forth in the SEC's NYSE Proxy Rate Rules Approval Order apply to Rule 2251 as revised by the rule change.<sup>10</sup>

## Summary Chart

TOPIC	NEW FINRA RULE . . .	CORRESPONDS TO NYSE RULE . . .
Definition of Nominee	FINRA Rule 2251.01(a)(1)(A)(i)	NYSE Rule 451.90(1)(a)(i)
Definition of Intermediary	FINRA Rule 2251.01(a)(1)(A)(ii)	NYSE Rule 451.90(1)(a)(ii)
Processing Unit Fees	FINRA Rule 2251.01(a)(1)(B)	NYSE Rule 451.90(1)(b)
Supplemental Fees for Intermediaries	FINRA Rule 2251.01(a)(1)(C)	NYSE Rule 451.90(1)(c)
Proxy Follow-Up Material	FINRA Rule 2251.01(a)(2)	NYSE Rule 451.90(2)
Beneficial Ownership Information	FINRA Rule 2251.01(a)(3)	NYSE Rule 451.92
Interim Report, Post-Meeting Report and Other Material	FINRA Rule 2251.01(a)(4)	NYSE Rule 451.90(3)
Preference Management Fees	FINRA Rule 2251.01(a)(5)	NYSE Rule 451.90(4)
Notice and Access Fees	FINRA Rule 2251.01(a)(6)	NYSE Rule 451.90(5)
Managed Accounts	FINRA Rule 2251.01(a)(7)	NYSE Rule 451.90(6)
EBIPs	FINRA Rule 2251.01(a)(8)	NYSE Rule 451.90(7)

## Endnotes

1. FINRA member firms that are NYSE members should refer to [NYSE Information Memo 14-03](#).
2. FINRA Rule 2251 was adopted as a consolidation of former NASD Rule 2260 and IM-2260 as part of FINRA's rulebook consolidation process. See Securities Exchange Act Release No. 61052 (November 23, 2009), 74 FR 62857 (December 1, 2009) (Order Granting Approval of Proposed Rule Change; File No. SR-FINRA-2009-066).
3. See Securities Exchange Act Release No. 70720 (October 18, 2013), 78 FR 63530 (October 24, 2013) (Order Granting Approval of Proposed Rule Change; File No. SR-NYSE-2013-07) (NYSE Proxy Rate Rules Approval Order).
4. See Securities Exchange Act Release No. 71272 (January 9, 2014), 79 FR 2741 (January 15, 2014) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change; File No. SR-FINRA-2013-056).
5. New FINRA Rule 2251.01(a)(1)(A)(i) defines "nominee" to mean a broker or bank subject to SEA Rule 14b-1 or Rule 14b-2, respectively.
6. New FINRA Rule 2251.01(a)(1)(A)(ii) defines "intermediary" to mean a proxy service provider that coordinates the distribution of proxy or other materials for multiple nominees.
7. Member firms should note that the EBIP fee does not apply to accounts that converted to electronic delivery prior to January 1, 2014.
8. Under the new NYSE proxy rate rules, the notification applies to NYSE member organizations as to the NYSE. To avoid regulatory duplication, the new FINRA rule applies the EBIP notification requirement only to FINRA member firms that are not NYSE members. However, as discussed in this *Notice*, all FINRA member firms would need to maintain, and would be subject to requests by FINRA for, the specified EBIP tracking information and records.
9. FINRA may specify a more detailed form for EBIP reporting at a future date. FINRA has not done so at this time.
10. See note 3.

## Alternative Display Facility

### SEC Approves Amendments to FINRA Rules 6271 and 6272 Regarding the Requirements For Firms Seeking Registration as FINRA Alternative Display Facility (ADF) Market Participants

Effective Date: February 3, 2014

#### Executive Summary

The Securities and Exchange Commission (SEC) has approved amendments to FINRA rules governing registration in and participation on the ADF. The amendments add new requirements to the application that prospective ADF market participants must submit to FINRA prior to submitting quotes on and reporting trades to the ADF. As part of the application process, the amendments require prospective ADF market participants to submit a deposit (ADF Deposit Amount) into escrow. The amendments also set forth the framework pursuant to which an ADF market participant may earn back some or all of its ADF Deposit Amount, enumerate additional documents that a firm seeking registration as an ADF market participant must execute, and clarify the process by which a firm's registration as an ADF market participant becomes effective.

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

Questions concerning this *Notice* or FINRA Rules 6271 and 6272 should be directed to:

- ▶ Chris Stone, Vice President, Transparency Services, at (202) 728-8457;
- ▶ Brendan Loonam, Director – Business Services, Transparency Services, at (212) 858-4203;
- ▶ Brant Brown, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-6927; or
- ▶ Andrew Madar, Associate General Counsel, OGC, at (202) 728-8071.

January 2014

#### Notice Type

- ▶ Rule Amendment

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Senior Management

#### Key Topics

- ▶ Alternative Display Facility

#### Referenced Rules & Notices

- ▶ FINRA Rule 6271
- ▶ FINRA Rule 6272

## Discussion

The ADF is a quotation collection and trade reporting facility that provides ADF market participants (*i.e.*, ADF-registered market makers or electronic communications networks (ECN)) the ability to post quotations, display orders and report transactions in NMS stocks for submission to Securities Information Processors for consolidation and dissemination to vendors and other market participants.<sup>1</sup> In connection with migrating the ADF to FINRA's Multi Product Platform (MPP), FINRA is amending the rules governing the operation of the ADF to add new registration requirements for prospective ADF market participants and to clarify the procedure by which an ADF market participant's registration becomes effective.

FINRA Rule 6271 currently requires that a firm seeking registration as an ADF market participant (either as a market maker or as an ECN) file an application with FINRA that, among other things, certifies the firm's good standing with FINRA, and demonstrates the firm's compliance with the net capital provisions of the Securities Exchange Act. FINRA has amended Rule 6271 to include additional items as part of a firm's application. Specifically, the firm must agree to submit an ADF Deposit Amount of \$250,000 in five equal installments into escrow. If the firm requests that FINRA accelerate the migration of the ADF to the MPP, or if the firm begins quoting on or reporting trades to the ADF within 90 calendar days after an ADF market participant that requested accelerated migration of the ADF begins quoting on and reporting trades to the ADF, the ADF Deposit Amount is \$500,000. The firm also must agree to the ADF deposit terms, which are set forth in greater detail in the rule. As part of the revised application, the firm must also agree that, for the two-year period following the effective date of its registration, failing to submit 75 percent of its quoting and trading volume to the ADF will result in the forfeiture of some or all of its ADF Deposit Amount, pursuant to the ADF deposit terms. Finally, the firm agrees to provide FINRA with reasonable monthly projections of the volume of data that it anticipates submitting to the ADF.

Rule 6271 also provides a framework through which an ADF market participant can earn back some or all of its ADF Deposit Amount through a credit structure based on the market data revenue associated with the firm's trade reporting activity on the ADF. The rule also addresses the treatment of the ADF Deposit Amount in the event the firm is sold, goes out of business, otherwise does not meet its obligations or fails to complete the process for becoming an ADF market participant. Finally, the rule provides for the release of a portion of the ADF Deposit Amount in the event that FINRA is unable to make the ADF available to a firm after a specified period of time.

FINRA has also amended Rule 6271 to require that firms seeking registration as ADF market participants submit two other items in addition to the application. Specifically, a firm seeking registration as an ADF market participant must execute a Participant Agreement with FINRA at least six months prior, or such other shorter time period as may be designated by FINRA, to quoting on or reporting trades to the ADF. The firm must also execute a Certification Record, pursuant to which it certifies its ability to comply with certain requirements of Regulation NMS.

FINRA also clarified the process by which a firm's registration as an ADF market participant becomes effective. Specifically, FINRA and the firm must execute both the firm's application to become an ADF market participant and the Participant Agreement. Additionally, the firm must execute the Certification Record, and the firm must receive a notice of approval from FINRA in the designated security types specified in its application.

## Endnote

1. Rule 600 of Regulation NMS defines a protected bid or offer as a "quotation in an NMS stock that (1) is displayed by an automated trading center; (2) is disseminated pursuant to an effective national market system plan; and (3) is an automated quotation that is the best bid or best offer of a national securities exchange, the best bid or best offer of The Nasdaq Stock Market, Inc., or the best bid or best offer of a national securities association other than the best bid or best offer of The Nasdaq Stock Market, Inc." See 17 CFR 242.600(b)(57). As such, the best bid or offer for a stock that is displayed on the ADF would constitute a protected bid or offer under Regulation NMS.

# Information Notice

## 2014 Annual Audit, FOCUS, Form Custody, Supplemental Statement of Income (SSOI) and Off-Balance Sheet (OBS) Report Filing Due Dates

### Executive Summary

FINRA reminds firms of their obligation to file Annual Audit, Financial and Operational Combined Uniform Single (FOCUS) Reports, Form Custody and FINRA required supplemental FOCUS Report information. All filings must be received by FINRA by their required due dates in order to avoid certain fees as set forth in FINRA's By-Laws and/or to avoid suspension of a firm's FINRA membership. This *Notice* provides the due dates for filings that firms must make in 2014.

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

**January 8, 2014**

### Suggested Routing

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

### Key Topic(s)

- ▶ Annual Audit Report Filings
- ▶ FOCUS Report Filings
- ▶ Form Custody Filings
- ▶ Supplemental Schedule for Derivatives and Other Off-Balance Sheet Items Report Filings
- ▶ Supplemental Statement of Income Report Filings

### Referenced Rules and Notices

- ▶ FINRA Rule 4530
- ▶ NASD Rule 3170
- ▶ Regulatory Notice 11-46
- ▶ Regulatory Notice 12-11
- ▶ Regulatory Notice 13-10
- ▶ SEA Rule 17a-5

## 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 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*.

### Annual Audit Reports

Period End	Due Date
December 31, 2013	March 3, 2014
January 31, 2014	April 1, 2014
February 28, 2014	April 29, 2014
March 31, 2014	May 30, 2014
April 30, 2014	June 30, 2014
May 31, 2014	July 30, 2014
June 30, 2014	August 29, 2014
July 31, 2014	September 29, 2014
August 31, 2014	October 30, 2014
September 30, 2014	December 1, 2014
October 31, 2014	December 30, 2014
November 30, 2014	January 29, 2015
December 31, 2014	March 3, 2015

As discussed in [Regulatory Notice 11-46](#), and pursuant to NASD Rule 3170, FINRA is requiring 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). Further, firms whose fiscal year end is December 31, 2013, or after, and which are members of SIPC, will also be required to file annual audit reports in hard copy with SIPC. Firms should refer to SIPC's [website](#) for filing instructions.

## FOCUS Reports

FINRA-regulated firms are required to submit FOCUS reports to FINRA pursuant to SEA Rule 17a-5. 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
December 31, 2013	January 27, 2014
January 31, 2014	February 26, 2014
February 28, 2014	March 25, 2014
April 30, 2014	May 23, 2014
May 31, 2014	June 24, 2014
July 31, 2014	August 25, 2014
August 31, 2014	September 24, 2014
October 31, 2014	November 25, 2014
November 30, 2014	December 23, 2014

### Quarterly FOCUS Part II/IIA Filings

Quarter Ending	Due Date
December 31, 2013	January 27, 2014
March 31, 2014	April 24, 2014
June 30, 2014	July 24, 2014
September 30, 2014	October 23, 2014
December 31, 2014	January 27, 2015

### Annual Schedule I Filings

Period	Due Date
2013	January 27, 2014
2014	January 27, 2015

## Form Custody

Pursuant to the newly approved SEA Rule 17a-5(a)(5), all broker-dealers are required to file Form Custody with their DEA at the same time they file their periodic quarterly FOCUS Reports with such DEA pursuant to SEA Rule 17a-5(a).

### Form Custody Filings

Quarter Ending	Due Date
December 31, 2013	January 27, 2014
March 31, 2014	April 24, 2014
June 30, 2014	July 24, 2014
September 30, 2014	October 23, 2014
December 31, 2014	January 27, 2015

## Supplemental Statement of Income (SSOI)

In [Regulatory Notice 12-11](#), FINRA announced the approval by the SEC of FINRA Rule 4524 (Supplemental FOCUS Information), which requires each firm, as FINRA shall designate, to file additional financial or operational schedules or reports. Concurrently with the approval of Rule 4524, the SEC approved the adoption of the Supplemental Statement of Income (SSOI), which all firms must file quarterly. For information about completing the SSOI, please see the [SSOI page](#) on FINRA's website.

### SSOI Filings

Quarter Ending	Due Date
December 31, 2013	January 30, 2014
March 31, 2014	April 29, 2014
June 30, 2014	July 29, 2014
September 30, 2014	October 28, 2014
December 31, 2014	January 30, 2015

## Supplemental Schedule for Derivatives and Other Off-Balance Sheet Items (OBS)

FINRA Rule 4524 (Supplemental FOCUS Information) requires each firm, as FINRA shall designate, to file additional financial or operational schedules or reports. In February 2013, FINRA published [Regulatory Notice 13-10](#) announcing the SEC's approval and FINRA's adoption of a supplemental schedule for derivatives and other OBS items that apply to carrying or clearing firms.

The OBS contains a *de minimis* exception for each reporting period. If the aggregate of all gross amounts of off-balance sheet items is less than 10 percent of the firm's excess net capital on the last day of the reporting period, the firm will not be required to file the OBS for the reporting period. **However, a firm that claims the *de minimis* exception must affirmatively indicate through the eFOCUS system that no filing is required for the reporting period.** Unless a carrying or clearing firm meets the *de minimis* exception, it is required to file the OBS within 22 business-days from the end of each calendar quarter using the eFOCUS system available through FINRA's Firm Gateway.

### OBS Form Filings

Quarter Ending	Due Date
December 31, 2013	February 3, 2014
March 31, 2014	May 1, 2014
June 30, 2014	July 31, 2014
September 30, 2014	October 30, 2014
December 31, 2014	February 3, 2015

## FINRA Gateway and Entitlements

Firms are reminded that they must use their current FINRA entitlement user ID and password to access the Firm Gateway. Questions regarding access to the Firm Gateway should be directed to the firm's Super Account Administrator (SAA). 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

1. The Facing Page requires basic identifying 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.
2. See [Annual Audit Extension of Time Request Policy](#) on FINRA's website. See also Section 4(g) of Schedule A to the FINRA By-Laws.
3. See [Regulatory Notice 11-46](#) (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 a calendar quarter.