

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61059; File No. SR-FINRA-2009-059)

November 24, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change to Adopt NASD Rules 2360 and 2361 into the Consolidated Rulebook as FINRA Rules 2130 and 2270

I. *Introduction*

On September 9, 2009, the Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt NASD Rule 2360 (Approval Procedures for Day-Trading Accounts) as FINRA Rule 2130 and to adopt NASD Rule 2361 (Day-Trading Risk Disclosure Statement) as FINRA Rule 2270 in the consolidated FINRA rulebook, with minor changes. The proposed rule change was published for comment in the Federal Register on October 8, 2009.³ The Commission received no comments on the proposal. This order approves the proposed rule change.

II. *Description of the Proposal*

As part of the process of developing a new consolidated rulebook (the “Consolidated FINRA Rulebook”),⁴ FINRA proposed to adopt NASD Rules 2360 and 2361 as FINRA

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 60754 (Oct. 2, 2009), 74 FR 51886.

⁴ The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the “Transitional Rulebook”). While the NASD Rules generally apply to all FINRA 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

Rules 2130 and 2270. NASD Rules 2360 and 2361 focus on members' obligations to disclose to non-institutional customers⁵ the basic risks of engaging in a "day-trading strategy" and to assess the appropriateness of day-trading strategies for such customers. The rules define a "day-trading strategy" as "an overall trading strategy characterized by the regular transmission by a customer of intra-day orders to effect both purchase and sale transactions in the same security or securities."⁶ NASD Rule 2360 creates an obligation on members that promote a day-trading strategy regarding account-opening approval procedures for non-institutional customers. NASD Rule 2361 creates an obligation on such members to disclose to non-institutional customers the unique risks of engaging in a day-trading strategy.

Approval Procedures for Day-Trading Accounts

NASD Rule 2360 prohibits a member promoting a day-trading strategy from opening an account for a non-institutional customer unless, prior to opening the account, the member has furnished the customer with a risk disclosure statement (as described in NASD Rule 2361) and has either (1) approved the customer's account for a day-trading strategy and prepared a record setting forth the basis for the approval; or (2) obtained from the customer a written agreement stating that the customer does not intend to use the account to engage in a day-trading strategy. The rule further requires that, in order to approve a customer's

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

⁵ For purposes of these rules, the term "non-institutional customer" means a customer that does not qualify as an "institutional account" under NASD Rule 3110(c)(4). See NASD Rule 2360(f); NASD Rule 2361(d). FINRA is proposing to adopt NASD Rule 3110(c)(4) as FINRA Rule 4512(c). See *Regulatory Notice* 08-25 (May 2008).

⁶ See NASD Rule 2360(e); NASD Rule 2361(c).

account for a day-trading strategy, a member must have reasonable grounds to make a determination that a day-trading strategy is appropriate for the customer.⁷

The proposed rule change would transfer NASD Rule 2360 with the following minor changes into the Consolidated FINRA Rulebook as FINRA Rule 2130. First, the proposed rule change would add Supplementary Material to clarify the concept of “promoting a day-trading strategy,” based on guidance provided in the 2000 FINRA *Notice* and the 2000 SEC Approval Order, as follows:

.01 Promoting a Day-Trading Strategy.

(a) A member shall be deemed to be “promoting a day-trading strategy” if it affirmatively endorses a “day-trading strategy,” as defined in paragraph (e) of this Rule, through advertising, its Web site, training seminars or direct outreach programs. For example, a member generally shall be deemed to be “promoting a day-trading strategy” if its advertisements address the benefits of day-trading, rapid-fire trading, or momentum trading, or encourage persons to trade or profit like a professional trader. A member also shall be deemed to be “promoting a day-trading strategy” if it promotes its day-trading services through a third party. Moreover, the fact that many of a member’s customers are engaging in a day-trading strategy will be relevant in determining whether a member has promoted itself in this way.⁸

Second, the proposed rule change would add Supplementary Material, based on guidance provided in the 2000 SEC Approval Order and the 2000 FINRA *Notice*, to specifically provide that a member may submit advertising materials to FINRA’s

⁷ In making such determination, the rule requires a member to exercise reasonable diligence to ascertain the essential facts relative to the customer, including investment objectives, investment and trading experience and knowledge, financial situation, tax status, employment status, marital status, number of dependents and age. *See* NASD Rule 2360(b).

⁸ To enhance the readability of the rule, the proposed rule change would relocate paragraph (g) of Rule 2360 regarding those activities that would not constitute “promoting a day-trading strategy,” as paragraph (b) of this new Supplementary Material .01.

Advertising Department for review and guidance on whether the content of the advertisement constitutes “promoting a day-trading strategy,” as follows:

.02 Review by FINRA’s Advertising Department. A member may submit its advertisements to FINRA’s Advertising Department for review and guidance on whether the content of the advertisement constitutes “promoting a day-trading strategy” for purposes of this Rule.

Third, the proposed rule change would add Supplementary Material to alert members of additional FINRA rules specifically addressing day-trading, including the rule addressing the Disclosure Statement (further discussed below) and rules regarding margin requirements.⁹

Finally, the proposal would make minor changes to the rule to update cross-references and format.

Day-Trading Risk Disclosure Statement

NASD Rule 2361 requires members that promote a day-trading strategy to deliver to their non-institutional customers, prior to opening an account for such customers, a risk disclosure statement, as specified in paragraph (a) of the rule (the “Disclosure Statement”).¹⁰ In addition, members that promote a day-trading strategy must post the Disclosure Statement on their Web sites in a clear and conspicuous manner. The Disclosure Statement includes seven specific points, described in more detail in the statement itself, addressing the factors that a customer should consider before engaging in day-trading.

The proposed rule change would transfer NASD Rule 2361 with the following minor changes into the Consolidated FINRA Rulebook as FINRA Rule 2270.

⁹ See proposed Supplementary Material .03 to proposed FINRA Rule 2130.

¹⁰ The rule provides that, in lieu of the disclosure statement specified in the rule, a member may use an alternative disclosure statement, provided that it is substantially similar to the specified disclosure statement and is approved by FINRA’s Advertising Department prior to use. See NASD Rule 2361(b).

First, the proposed rule change would slightly modify the rule's existing provisions regarding form of delivery of documents. Currently, the rule provides that the disclosure statements may be provided to individuals either "in writing or electronically." Because in some circumstances electronic documents may be considered a form of "writing," the proposal would amend the rule to clarify that the documents may be provided "in paper or electronic form."

Second, to comport with the proposed revisions to NASD Rule 2360, the proposed rule change would add a statement to FINRA Rule 2270 that the term "promoting a day-trading strategy" shall have the meaning as provided in FINRA Rule 2130.

Third, the proposed rule change would add Supplementary Materials similar to those proposed to be added to FINRA Rule 2130, as discussed above, to specifically provide that a member may submit advertising materials to FINRA's Advertising Department for review and guidance on whether the content of the advertisement constitutes "promoting a day-trading strategy" and to alert members of additional FINRA rules specifically addressing day-trading.¹¹

Finally, the proposed rule change would make minor changes to the rule to update cross-references and format.

III. *Discussion*

Day-trading raises unique investor protection concerns. In general, day traders seek to profit from very small movements in the price of a security. Such a strategy often requires aggressive trading of a brokerage account and the use of strategies including margin trading and short selling. As a result, day-trading generally requires a significant amount of

¹¹ See proposed Supplementary Material .01 and .02 to proposed FINRA Rule 2270.

capital, a sophisticated understanding of securities markets and trading techniques, and a high tolerance for risk. Even experienced day traders with in-depth knowledge of the securities markets may suffer severe and unexpected financial losses.

Firms that are actively promoting a day-trading strategy should be responsible for assessing whether the strategy is appropriate for an individual who opens a day-trading account at that firm. These firms also should be required to disclose the risks of engaging in a day-trading strategy to an individual prior to opening an account for that individual. NASD Rules 2360 and 2361 were designed to assure that firms promoting a day-trading strategy check to make certain that day-trading is an appropriate investment strategy for a customer opening a day-trading account and that the customer is aware of its risks.

After careful review, the Commission finds that transferring NASD Rules 2360 and 2361, with the changes specified above, into the FINRA Consolidated Rulebook as FINRA Rules 2130 and 2270 is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.¹² In particular, the Commission finds that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹³ which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

More specifically, the Commission believes requiring a member firm to disclose the risks of day-trading to non-institutional customers when the firm promotes a day-trading strategy should help alert individuals to the risks associated with a day-trading strategy. In

¹² In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. See 15 U.S.C. 78c(f).

¹³ 15 U.S.C. 78o-3(b)(6).

addition, requiring a member firm to determine whether a day-trading strategy is appropriate for a customer should help to assure that individuals who are unable to bear the risks of day-trading, or who have investment objectives incompatible with day-trading, are not approved for day-trading.

IV. *Conclusion*

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-FINRA-2009-059) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Elizabeth M. Murphy
Secretary

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12)