

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-62842; File No. SR-FINRA-2010-030)

September 3, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority; Order Granting Approval of a Proposed Rule Change to Adopt FINRA Rule 11000 Series (Uniform Practice Code) in the Consolidated FINRA Rulebook

I. Introduction

On June 14, 2010, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-FINRA-2010-030 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).<sup>1</sup> Notice of the proposal was published in the Federal Register on July 12, 2010.<sup>2</sup> The Commission received no comment letters. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”), FINRA will adopt the NASD Rule 11000 Series (Uniform Practice Code [“UPC”]) into the Consolidated FINRA Rulebook, subject to certain amendments described below.<sup>3</sup> The UPC was originally adopted on January 20, 1941, and became effective on August 1, 1941. The

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> Securities Exchange Act Release No. 62454 (July 6, 2010), 75 FR 39715 (July 12, 2010).

<sup>3</sup> 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.

UPC prescribes the manner in which over-the-counter securities transactions other than those cleared through a registered clearing agency are compared, cleared, and settled between member firms.

As a general matter, the UPC does not apply to:

- a. transactions in securities between members that are compared, cleared, or settled through the facilities of a registered clearing agency;
- b. transactions in securities exempted under Section 3(a)(12) of the Act or in municipal securities as defined in Section 3(a)(29) of the Act;
- c. transactions in redeemable securities issued by companies registered under the Investment Company Act of 1940; or
- d. transactions in Direct Participation Program securities.

The UPC is designed to make uniform, where practicable, custom, practice, usage, and trading technique in the investment banking and securities business, particularly with respect to operational and settlement issues. This can include such matters as trade terms, deliveries, payments, dividends, rights, interest, stamp taxes, claims, assignments, powers of substitution, due-bills, transfer fees, and marking to the market. The UPC, among other things, was created so that the transaction of day-to-day business by members may be simplified and facilitated.

1. UPC Rules Generally

FINRA will transfer a significant portion of the NASD Rule 11000 Series into the Consolidated FINRA Rulebook with the minor changes detailed below.<sup>4</sup> Specifically, FINRA will update certain terminology in the UPC. For example, NASD Rule 11120 defines the term “written notice” as used in the UPC to include a notice delivered by hand, letter, teletype, telegraph, TWX, facsimile transmission, or other comparable media. FINRA will delete the references to teletype, telegraph, and TWX and will include notice delivered by electronic mail. In addition, FINRA will update cross-references throughout the rules and will make other minor changes primarily to reflect the new conventions of the Consolidated FINRA Rulebook.

2. Proposed FINRA Rules 11111 (Refusal to Abide by Rulings of the Committee) and 11112 (Review by Panels of the UPC Committee)

FINRA will adopt two new provisions that are largely based on former NASD IM-11890-1 (Refusal to Abide by Rulings) and NASD IM-11890-2 (Review by Panels of the UPC Committee).<sup>5</sup> The provisions of former NASD IM-11890-1 will be incorporated into and merged with current NASD IM-11110 (Refusal to Abide by Rulings of the Committee) and adopted as proposed new FINRA Rule 11111 as the two provisions are largely identical. Former NASD IM-11890-1 provided that a refusal by a member to take action necessary to effectuate a final decision of a FINRA officer or the UPC Committee under NASD Rule 11890 (Clearly Erroneous Transactions) would be considered conduct inconsistent with just and equitable

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<sup>4</sup> NASD Rules 11890 (Clearly Erroneous Transactions), IM-11890-1 (Refusal to Abide by Rulings), and IM-11890-2 (Review by Panels of the UPC Committee) were adopted, with significant changes, into the Consolidated FINRA Rulebook as the FINRA Rule 11890 Series (Clearly Erroneous Transactions) pursuant to a separate rule filing and are not being addressed as part of this rule filing. Securities Exchange Act Release No. 61080 (Dec. 1, 2009), 74 FR 64117 (Dec. 7, 2009) (SR-FINRA-2009-068).

<sup>5</sup> Id.

principles of trade. Current NASD IM-11110 provides that a refusal by a member to abide by an official ruling of the UPC Committee, acting within its appropriate sphere, shall be considered conduct inconsistent with just and equitable principles of trade. As approved, the new FINRA Rule 11111 will merge the two provisions and provide that a refusal by a member to take action necessary to effectuate a final decision of a FINRA officer or the UPC Committee under the UPC Code (FINRA Rule 11000 Series) or other FINRA rules that permit review of FINRA decisions by the UPC Committee will be considered conduct inconsistent with just and equitable principles of trade.

The provisions of former NASD IM-11890-2, which applied only to rulings under NASD Rule 11890, will be adopted as proposed new FINRA Rule 11112 (Review by Panels of the UPC Committee) and will be generally applicable to all rulings by the UPC Committee. The new FINRA Rule 11112 will provide that a decision of the UPC Committee may be rendered by a panel of the Committee, which shall consist of three or more members of the UPC Committee, provided no more than 50 percent of the members of any panel are directly engaged in market making activity or employed by a firm whose revenues from market making activity exceed ten percent of its total revenues.

3. Proposed FINRA Rules 11810 (Buying-In) and 11810.03 (Sample Buy-In Forms)

As approved by this filing, the current NASD Rule 11810 (Buying-In) will be adopted as FINRA Rule 11810 (Buy-In Procedures and Requirements) in the Consolidated FINRA Rulebook with certain clarifications and changes Incorporated NYSE Rules 282 (Buy-in Procedures) and related Supplementary Material paragraphs .10-.80 be deleted. The changes are intended to harmonize the differences between the NYSE rule and the NASD rule and to update

certain procedures and time frames. FINRA will also adopt NASD IM-11810, which contains the sample buy-in forms, into the Consolidated FINRA Rulebook as accompanying Supplementary Material .03 to FINRA Rule 11810 with minor changes to replace references to NASD with FINRA.

As approved, FINRA Rule 11810 will continue to set forth the required steps that members must follow to effect the “buy-in” of securities including the procedures to be followed in issuing a “buy-in” notice, the contents of such notice, the expectations of the receiving party to respond to such notice, and the time frames in which a “buy-in” may be issued, retransmitted, and effected.

FINRA will also make certain minor clarifications and add the following more substantive provisions to proposed FINRA Rule 11810, which are currently contained in NYSE Rule 282 either with or without modifications, as specified:

a. Include in paragraph (a) a statement clarifying that the rule does not apply to, among other things, securities contracts that are subject to the requirements of a national securities exchange or a registered clearing agency.

b. Amend certain time frames for action specified in the proposed rule:

i. Clarify the time frames within which members must take action to effect the “buy-in” of securities as required therein. Specifically, the NASD rule requires that a member act within the specified local time at the member’s location whereas the NYSE rule requires action to be taken based on Eastern Time (ET). To promote operational consistency among members, the proposal would amend the required time frame for action to be ET.

ii. Amend the current time frames specified by the NASD and NYSE rules for the acknowledgement of a “buy-in” notice and the notification of an execution of the buy-in from 5

p.m. to 6 p.m. ET. FINRA understands that the 5 p.m. time may be operationally difficult for members to achieve in some cases and the 6 p.m. ET time frame would be more operationally feasible.

iii. Add Supplementary Material .01 (Early Closure of Markets) to clarify that in the event of an announced early closure of the market upon which the security subject to the “buy-in” notice is traded, members may take the action required by the rule not earlier than one hour prior to the announced early closure of such market.

c. Add new paragraph (b)(4) to specify that (1) the buyer must maintain as part of its records, confirmation of receipt of the notice by the seller and (2) if the seller does not accept the notice of “buy-in,” it must reject it by response to the buyer no later than 6 p.m. ET on the same date that it receives such notice, and in the absence of doing so, the seller will have been deemed by the buyer to have accepted such notice. The provision would clarify that the seller, in such case, would have the right to request proof of the fail obligation from the buyer, which the buyer must deliver to the seller prior to the effective date of the “buy-in.” However, in no event would a buyer be entitled to a “buy-in” that exceeds the liability of a seller under an unsettled securities contract because of the failure of the seller to reject a “buy-in” notice as provided in the rule, and a buyer may not execute a “buy-in” notice to such extent the buyer fails to deliver the proof of fail obligation in accordance with the requirements of the rule. Requirements (1) and (2) described above are contained in the current NYSE rule in a similar form except FINRA will change the time to 6 p.m. ET. FINRA is also adding new provisions regarding “passive acceptance” of the “buy-in” by the seller as described above, subject to certain safeguards for the benefit of the seller such as requiring the buyer to provide the proof of fail obligation and

“buying-in” the seller only for the securities contract amount in accordance with the proposed rule.

d. Add new paragraph (b)(5) to specify that the receiving party shall immediately retransmit a notice of “buy-in” to other parties from which the securities may be due in the form of a retransmitted “buy-in” notice. Consistent with new paragraph (b)(4) described above, the provision would clarify that each party receiving a retransmitted “buy-in” notice will be required to maintain confirmation of receipt of the notice as part of its books and records and either reject a retransmitted “buy-in” notice that it has received by 6 p.m. ET on the date such notice is received or be deemed to have accepted the notice (“passive acceptance”). The safeguards described above in proposed paragraph (b)(4) would also apply to sellers receiving a retransmitted notice.

e. Add new paragraph (b)(6), which is contained in the NYSE rule, to clarify that when a notice of “buy-in” or a retransmitted notice thereof is given for less than the full amount of securities due, it shall not be for less than one trading unit.

f. Amend paragraph (d) as follows:

i. Retitle proposed paragraph (d) from the current rule title “Seller’s Failure to Deliver After Receipt of Notice” to “Procedures for Closing of Contracts” to better align the title with the content of that paragraph.

ii. Amend the time frames, as discussed generally above, to generally require the party receiving the “buy-in” notice to deliver the securities to the party issuing the notice by 3 p.m. ET on the effective date of the “buy-in” notice.

iii. Add language to clarify that if the buyer/issuing party prior to executing the “buy-in” is notified by the seller/delivering party that some or all of the securities are in the

seller's physical possession and will be delivered to the issuing party then the order to "buy-in" shall not be executed with respect to such securities, and the member that initiated the original order to "buy-in" shall accept and pay for such securities. However, if such securities are not promptly delivered, the seller that represented that it would make such delivery shall be liable for any resulting damages.

iv. Add language contained in the NYSE rule to clarify the operation of the rule when a retransmitted buy-in notice is sent to the defaulting party but is not received by such party prior to the delivery of shares or the execution of the "buy-in." In such case, the sender of the buy-in notice may unless otherwise agreed promptly reestablish by a new sale the contract subject to the notice of "buy-in."

g. Amend paragraph (h) as follows:

i. Amend the time frame, as discussed above, for notice to be made to the party for whose account the securities were bought to 6 p.m. ET on the date of execution of the "buy-in."

ii. Add new language, not contained in either legacy rule, to clarify that the confirmation of the executed "buy-in" provided for by the rule shall be forwarded to the party entitled to the confirmation by no later than 9:30 a.m. ET on the following business day after the execution of the "buy-in."

iii. Add a provision contained in the NYSE rule that requires that a statement of any resulting money differences from the execution of the "buy-in" be provided immediately and that such money differences shall be paid by no later than 3 p.m. ET on the business day after the settlement date of the executed "buy-in."



h. Amend paragraph (i) to clarify, as provided in the NYSE rule, that notification of all close-outs as provided by the paragraph shall be sent immediately to the member being closed-out pursuant to the confirmation provisions of the Rule 11200 Series at least thirty minutes before such “close-out.”

i. Add Supplementary Material .02 to clarify, as provided in the NYSE rule, that where securities have been delivered by the seller after the “buy-in” order has been placed but not executed, such securities may be returned to the seller if the “buy-in” was executed in accordance with the rule before it could reasonably be cancelled by the initiating party.

#### 4. Proposed FINRA Rule 11820 (Selling-Out)

Current NASD Rule 11820 (Selling-Out) will be adopted as FINRA Rule 11820 (Selling-Out) into the Consolidated FINRA Rulebook, subject to minor changes. There is no comparable NYSE rule. NASD Rule 11820 generally requires the party executing the “sell-out” to notify the buyer on the day of execution no later than the close of business local time where the buyer maintains his office of the quantity sold and the price received. FINRA will conform the time frames in this new rule to the time frames in the new FINRA Rule 11810 (Buy-In Procedures and Requirements). Specifically, this new rule will replace the requirement to provide notice “no later than the close of business local time, where the buyer maintains his office” with the requirement that such notice must be provided no later than “6:00 p.m. ET.” FINRA believes this change provides clarity and uniformity to the industry. In addition, the rule will amend certain references in the proposed rule from “should” to “shall.” Specifically, in paragraph (b), notification by the party executing a “sell-out” shall be in written or electronic form, and a formal confirmation of such sale shall be forwarded as promptly as possible after execution of the “sell-out.”

5. Proposed FINRA Rule 11860 (COD Orders)

FINRA will adopt NASD Rule 11860 (Acceptance and Settlement of COD Orders) as FINRA Rule 11860 (COD Orders) into the Consolidated FINRA Rulebook subject to minor changes and to delete NASD Rule 3370 (Purchases) and Incorporated NYSE Rule 387 (COD Orders) and its Supplementary Material paragraphs .10-.60, NYSE Rule 387 Interpretations /01 - /18, Rule 430 (Partial Delivery of Securities to Customers on C.O.D. Purchases), and NYSE Rule 430 Interpretation /01.

NASD Rule 11860 and NYSE Rule 387 provide generally that no member can accept an order from a customer pursuant to an arrangement whereby payment for the securities purchased or delivery of the securities sold is to be made to or by an agent of the customer unless certain specified procedures are followed. NASD Rule 3370 and NYSE Rule 430 both generally provide that no member or associated person may accept a customer's purchase order for securities unless it has first ascertained that the customer placing the order or its agent has agreed to receive the securities against payment in an amount equal to the execution price even though such purchase may represent only a part of a larger order. NYSE Rule 430 has an exception for obligations of the U.S. government.

As approved, FINRA Rule 11860 will continue the requirement in NYSE Rule 430 and NASD Rule 3370 that members prior to accepting a purchase order for a security ascertain that the customer or its agent will receive against payment securities in an amount equal to any execution confirmed to the customer even if such execution may represent a partial fill of the order. FINRA will eliminate the exemption for transactions in U.S. government obligations as provided by Rule 430. Further, the rule as being adopted will continue to require the use of either a Clearing Agency or a Qualified Vendor for the electronic confirmation and affirmation

of all depository eligible transactions. FINRA is clarifying that the new rule will, similar to NYSE Rule 387, apply to (1) transactions of foreign customers and broker-dealers that settle in the U.S. and (2) eligible sinking funds and/or dividend reinvestment transactions. The new rule will add a new requirement that is contained in NYSE Rule 387 that requires a “Qualified Vendor” to provide FINRA with copies of its required submissions to the SEC staff.

6. Proposed FINRA Rules 11870 (Customer Account Transfer Contracts) and 11870.03 (Sample Transfer Instruction Forms)

FINRA is adopting NASD Rule 11870 as FINRA Rule 11870 (Customer Account Transfer Contracts) into the Consolidated FINRA Rulebook with the following changes. There is no comparable NYSE Incorporated Rule.<sup>6</sup> FINRA is also adopting NASD IM-11870, which contains the Sample Transfer Instruction Forms, into the Consolidated FINRA Rulebook with minor changes to replace references to NASD with FINRA.

Generally, NASD Rule 11870 provides that when a brokerage customer wishes to transfer his or her account to another member and gives written notice of that fact to the receiving member, both members must expedite and coordinate the transfer. The new FINRA Rule 11870 would continue to set forth the required steps that members must follow to effect the transfer of customers’ accounts, including the initial request to transfer an account, the time

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<sup>6</sup> Previously, NYSE Rule 412 (Customer Account Transfer Contracts) and its related interpretations similarly regulated the transfer of customer accounts. FINRA eliminated NYSE Rule 412 and its interpretations from the Transitional Rulebook as part of a rule change to reduce regulatory duplication for Dual Members during the period before completion of the Consolidated FINRA Rulebook. The NYSE subsequently amended its version of NYSE Rule 412 to state that NYSE members and member organizations shall comply with NASD Rule 11870, concerning the transfer of customer accounts between members, and any amendments thereto, as if such rule were part of the NYSE’s rules. Securities Exchange Act Release No. 58533 (Sept. 12, 2008), 73 FR 54652 (Sept. 22, 2008) (Approval Order; SR-FINRA-2008-036).

frame in which a transfer request must be acted upon, the validation of such transfer request, and the documentation required to effect the transfer. FINRA will add to proposed FINRA Rule 11870 minor clarifications as well as the following more substantive, which were interpretations to the prior version of NYSE Rule 412<sup>7</sup>:

a. Add a new provision regarding the procedures for the transfer of book-entry mutual fund shares that clarifies the obligations of the parties when transferring a customer's positions in such securities. FINRA will add this provision to paragraph (f)(9) of proposed FINRA Rule 11870.

b. Add a definition of the term "participant in a registered clearing agency" for purposes of the rule to mean a member that is eligible to use the agency's automated customer securities account transfer capabilities.

c. Add Supplementary Material .01 to clarify that members must establish written procedures to effect and supervise the transfer of customer account assets pursuant to the requirements of the proposed rule.

d. Add Supplementary Material .02 to require members to inform customers with respect to retirement plan securities that the choice of the method of disposition of such assets may result in liability for the payment of taxes and penalties.

e. Amend the time frames in the new rule for notice and completion of close-outs of fail contracts resulting from the not completing a transfer of a customer's account to conform to the time frames for all close-outs as specified in proposed FINRA Rule 11810 (Buy-In Procedures and Requirements). Specifically, the new rule will require the receiving member to provide

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<sup>7</sup>

Id.

notice to the carrying member not later than 12 noon ET two business days preceding the execution of the proposed close-out (as opposed to 12:00 noon “his” time). In addition, the rule will require that every notice of close-out state that the securities may be closed out “unless delivery is effected at or before a certain specified time, which may not be prior to 3 pm ET,” as opposed to “the local time in the community where the carrying member maintains his office.” The new rule will also replace the requirement that the party executing the “close-out” notify the seller as to the quantity purchased and the price paid not later than “the close of business, local time, where the seller maintains his office,” with the requirement to provide such notice not later than “6 p.m. ET on the date of the execution of such ‘close-out’.”

f. Amend certain references in the new rule from “should” to “shall.” Specifically, (1) in paragraph (f) that the obligation that fail contracts established pursuant to the rule shall be clearly marked or captioned as such and that a receiving member shall reject delivery of a security that cannot be deemed a safekeeping position against a fail contract; (2) in paragraph (h) that notification shall be in written or electronic form and that confirmation of purchase along with a billing or payment shall be forwarded as promptly as possible; (3) in paragraph (i) that notification shall be in written or electronic form; and (4) in paragraph (m) that when both members are participants in a registered clearing agency, the securities account asset transfer procedures shall be accomplished in accordance with the rule and the rules of the registered clearing agency.

g. Eliminate paragraph (n)(3) which requires that a copy of each customer account transfer instruction issued on an “ex-clearing house” basis be sent to the local District Office of NASD having jurisdiction over the carrying member. FINRA believes that a majority of

customer account transfers now occur between members of a clearing agency and that the volume of transactions that occur “ex-clearing” has significantly decreased.

FINRA will announce the implementation date of the rule change in a Regulatory Notice to be published no later than ninety days following the date of the approval of this rule change. The implementation date will be no later than 365 days following the date of the approval of this rule change.

### III. Discussion

Section 15A(b)(6) of the Act requires, among other things, that FINRA rules must be designed to promote just and equitable principles of trade and, in general, to protect investors and the public interest.<sup>8</sup> The rule change amends FINRA’s rules so as to adopt a majority of the UPC Rules into the new Consolidated FINRA Rulebook without significant changes in order to update and to reflect the new conventions of the Consolidated FINRA Rulebook. The rule change also updates certain other UPC Rules to reflect current industry practices. As one part of a larger undertaking to consolidate the rules of the NASD and NYSE, FINRA’s new rules will apply to all registered broker-dealers, which should further promote the just and equitable principles of trade and, in general, better protect investors and the public interest.

Accordingly, for the reasons stated above the Commission believes that the rule change is consistent with FINRA’s obligation under Section 15A of the Exchange Act, as amended, and the rules and regulations thereunder.<sup>9</sup>

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<sup>8</sup> 15 U.S.C. 78o-3(b)(6).

<sup>9</sup> 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).

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of Section 15A of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-FINRA-2010-030) be and hereby is approved.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>10</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).

