

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-60754; File No. SR-FINRA-2009-059)

October 2, 2009

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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on September 9, 2009, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) 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, as described in Items I, II, and III below, which Items substantially have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

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

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

<sup>2</sup> 17 CFR 240.19b-4.

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

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

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

1. Purpose

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”),<sup>3</sup> FINRA is proposing to adopt NASD Rules 2360 and 2361 in the consolidated FINRA rulebook with minor changes, as FINRA Rules 2130 and 2270 respectively.

NASD Rules 2360 and 2361 focus on members’ obligations to disclose to non-institutional customers<sup>4</sup> the basic risks of engaging in a “day-trading strategy” and to assess the appropriateness of day-trading strategies for such customers. The rules

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

<sup>4</sup> 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).

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.”<sup>5</sup> 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.

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 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.<sup>6</sup>

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

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<sup>5</sup> See NASD Rule 2360(e); NASD Rule 2361(c).

<sup>6</sup> 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).

“Disclosure Statement”).<sup>7</sup> 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 following factors that a customer should consider before engaging in day-trading, as follows:

- (1) Day trading can be extremely risky.
- (2) Be cautious of claims of large profits from day trading.
- (3) Day trading requires knowledge of securities markets.
- (4) Day trading requires knowledge of a firm’s operations.
- (5) Day trading will generate substantial commissions, even if the per trade cost is low.
- (6) Day trading on margin or short selling may result in losses beyond your initial investment.
- (7) Potential registration requirements (*i.e.*, persons providing investment advice for others or managing securities accounts for others may need to register as an investment adviser or broker or dealer; such activities also may trigger state registration requirements).

Although these rules define “day-trading strategy,” neither defines “promoting a day-trading strategy.” NASD Rule 2360 does provide, however, that a firm will *not* be deemed to be “promoting a day-trading strategy” solely by engaging in the following activities:

- (1) promoting efficient execution services or lower execution costs based on multiple trades;
- (2) providing general investment research or advertising the high quality or prompt availability of such general research; and

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<sup>7</sup> 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).

- (3) having a Web site that provides general financial information or news or that allows the multiple entry of intra-day purchases and sales of the same securities.<sup>8</sup>

Additional guidance regarding as to what constitutes “promoting a day-trading strategy” can be found in the SEC order approving the adoption of NASD Rule 2360 and 2361 (the “2000 SEC Approval Order”) and FINRA’s *Notice* announcing SEC approval of the rules (the “2000 FINRA *Notice*”).<sup>9</sup> For example, the 2000 FINRA *Notice* provides:

A member will be subject to the day-trading rules if it affirmatively promotes day-trading activities or strategies through advertising, training seminars, or direct outreach programs. For instance, a firm generally will be subject to the new rules if its advertisements address the benefits of day trading, rapid-fire trading, or momentum trading, or encourages persons to trade or profit like a professional trader. A firm also will be subject to the new rules if it promotes its day-trading services through a third party. Moreover, the fact that many of a firm’s customers are engaging in a day-trading strategy will be relevant in determining whether a firm has promoted itself in this way.<sup>10</sup>

The 2000 SEC Approval Order and the 2000 FINRA *Notice* also state that a member may submit an advertisement to FINRA’s Advertising Department for review and

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<sup>8</sup> See NASD Rule 2360(g).

<sup>9</sup> See Securities Exchange Act Release No. 43021 (July 10, 2000), 65 FR 44082 (July 17, 2000) (Approval Order; File No. SR-NASD-99-41); *Notice to Members* 00-62 (September 2000) (announcing SEC approval of Rules 2360 and 2361).

<sup>10</sup> See 2000 FINRA *Notice*. See also 2000 SEC Approval Order, 65 FR at 44082-83.

guidance on whether the content of the advertisement constitutes “promoting a day-trading strategy” for purposes of NASD Rules 2360 and 2361.<sup>11</sup>

*Proposed FINRA Rule 2130*

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.<sup>12</sup>

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

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<sup>11</sup> See 2000 SEC Approval Order, 65 FR at 44083-44084; 2000 FINRA *Notice*, at note 2.

<sup>12</sup> 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.<sup>13</sup>

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

*Proposed FINRA Rule 2270*

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

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

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<sup>13</sup> See proposed Supplementary Material .03 to proposed FINRA Rule 2130.

“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.<sup>14</sup>

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

FINRA intends to announce the implementation date of the proposed rule change in a *Regulatory Notice* to be published no later than 90 days following Commission approval.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>15</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA continues to believe that the required approval process for day-trading accounts serves to protect investors engaged in day-trading activities, and the requisite disclosures in the Disclosure Statement increase investors’ understanding of the risks

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<sup>14</sup> See proposed Supplementary Material .01 and .02 to proposed FINRA Rule 2270.

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



associated with day trading. FINRA believes that the proposed rule change will provide greater clarity regarding these requirements.

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

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

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

Written comments were neither solicited nor received.

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

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

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

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

IV. *Solicitation of Comments*

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

*Electronic Comments:*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2009-059 on the subject line.

*Paper Comments:*

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

All submissions should refer to File Number SR-FINRA-2009-059. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You

should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2009-059 and should be submitted on or before [insert date 21 days from publication in the *Federal Register*].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>16</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>16</sup> 17 CFR 200.30-3(a)(12).