

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-62482; File No. SR-FINRA-2010-024)

July 12, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change to Adopt FINRA Rule 4210 (Margin Requirements), FINRA Rule 4220 (Daily Record of Required Margin) and FINRA Rule 4230 (Required Submissions for Requests for Extensions of Time under Regulation T and SEC Rule 15c3-3) in the Consolidated FINRA Rulebook

I. Introduction

On May 14, 2010, 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 FINRA Rule 4210 (Margin Requirements), FINRA Rule 4220 (Daily Record of Required Margin) and FINRA Rule 4230 (Required Submissions for Requests for Extensions of Time under Regulation T and SEC Rule 15c3-3) as part of the process of developing a consolidated FINRA rulebook. The proposed rule change was published for comment in the Federal Register on June 8, 2010.³ The Commission received no comments on the proposal. This order approves the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 62205 (June 2, 2010), 75 FR 32519 (June 8, 2010).

II. Description of the Proposal

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”),⁴ FINRA proposes to adopt (1) NASD Rules 2520, 2521, 2522, and IM-2522 regarding margin requirements, (2) NASD Rule 3160 regarding extension of time requests under Regulation T and SEC Rule 15c3-3, and (3) Incorporated NYSE Rule 432(a) regarding daily record of margin requirements as FINRA rules in the Consolidated FINRA Rulebook, subject to certain amendments, and to delete Incorporated NYSE Rule 431 (Margin Requirements), Incorporated NYSE Rule 431 Interpretations,⁵ Incorporated NYSE Rule 432(b) and Incorporated NYSE Rule 434 (Required Submissions of Requests for Extension of Time for Customers). The proposed rule change would (1) consolidate and renumber NASD Rules 2520, 2521, 2522 and IM-2522 as FINRA Rule 4210 (Margin Requirements), (2) renumber NASD Rule 3160 as FINRA Rule 4230 (Required Submissions for Requests for Extensions of Time Under Regulation T and SEC Rule 15c3-3), and (3) renumber Incorporated NYSE Rule 432(a) as FINRA Rule 4220 (Daily Record of Required Margin) in the Consolidated FINRA Rulebook.

Margin Requirements – NASD Rules 2520, 2521, 2522, and IM-2522 and Incorporated NYSE Rule 431

FINRA proposes to adopt the margin requirements set forth in NASD Rules 2520 through 2522 and IM-2522 as FINRA Rule 4210, subject to certain amendments, discussed below and to

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

⁵ See supra note 4.

delete Incorporated NYSE Rule 431 (Margin Requirements). The proposed amendments, among other things, reflect certain requirements in Incorporated NYSE Rule 431.

NASD Rule 2520 (Margin Requirements) and Incorporated NYSE Rule 431, which are almost identical, prescribe requirements governing the extension of credit by members that offer margin accounts to customers, as generally permitted in accordance with Regulation T of the Board of Governors of the Federal Reserve System (“Regulation T”).⁶ These rules promulgate the margin requirements that determine the amount of collateral customers are expected to maintain in their margin accounts, including strategy-based margin accounts and portfolio margin accounts. Maintenance margin requirements for equity, fixed income, warrants and option securities also are established under these rules.

Rule Structure

FINRA proposes to combine NASD Rules 2520, 2521, 2522 and IM-2522 into the single consolidated margin rule, FINRA Rule 4210. In addition, FINRA proposes to re-structure the rule to improve its organization and make it easier to read. First, FINRA proposes to incorporate NASD Rule 2521 (Margin – Exemption for Certain Members) as FINRA Rule 4210(h), which provides that any member for which another self-regulatory organization acts as the designated examining authority is exempt from FINRA Rule 4210. Second, FINRA proposes to incorporate NASD Rule 2522 (Definitions Related to Options, Currency Warrants, Currency Index Warrants and Stock Index Warrant Transactions) as FINRA Rule 4210(f)(2)(A), which contains definitions regarding margining options, currency warrants, currency index warrants and stock index warrant transactions.⁷ In so doing, FINRA proposes to delete extraneous definitions and

⁶ See Regulation T, 12 CFR 220.4.

⁷ In this regard, FINRA proposes to adopt the model of Incorporated NYSE Rule 431 of consolidating relevant definitions into FINRA Rule 4210.

retain only those definitions that are pertinent to the new rule. Third, FINRA proposes to combine the margin provisions regarding currency warrants, currency index warrants and stock index warrants from NASD Rule 2520(f)(10) together with similar sections in paragraph (f)(2) of FINRA Rule 4210. All margin provisions regarding such warrants were combined in a single section in corresponding Incorporated NYSE Rule 431(f)(2), and FINRA proposes to follow this model. FINRA believes combining all provisions in a single section regarding such warrants will make the rule easier to read. Finally, FINRA proposes to incorporate NASD IM-2522 (Computation of Elapsed Days) as Supplementary Material to FINRA Rule 4210, which provides illustrations on how to calculate the number of elapsed days for accrued interest on Treasury bonds or notes.

Net Capital Calculations

FINRA proposes in several instances in FINRA Rule 4210⁸ to specify that the member should reference SEC Rule 15c3-1 and, if applicable, FINRA Rule 4110 (Capital Compliance) when calculating net capital, charges against net capital and haircut requirements. Members that may be subject to greater net capital requirements pursuant to FINRA Rule 4110 would need to ensure they are in compliance with both the SEC and FINRA net capital provisions in calculating net capital and its impact on margin calculations. In addition, consistent with the corresponding Incorporated NYSE Rule 431 requirements, FINRA proposes to provide in FINRA Rule 4210(e)(5)(A) and (B) (regarding specialists' and market makers' accounts), (e)(6)(A) (regarding broker-dealer accounts) and (e)(6)(B)(i)c. (regarding joint back office arrangements) that when computing charges against net capital for transactions in securities covered by FINRA Rule

⁸ See, e.g., FINRA Rule 4210(e)(2)(D), (e)(2)(F), (e)(2)(G), (e)(4), (e)(5) and (e)(6). Incorporated NYSE Rule 431 referenced NYSE's net capital rules in these same sections, and FINRA proposes to follow this model.

4210(e)(2)(F) (regarding transactions with exempt accounts involving certain “good faith” securities) and FINRA Rule 4210(e)(2)(G) (regarding transactions with exempt accounts involving highly rated foreign sovereign debt securities and investment grade debt securities), absent a greater haircut requirement that may have been imposed on such securities pursuant to FINRA Rule 4110(a), the respective requirements of those paragraphs may be used, rather than the haircut requirements of SEC Rule 15c3-1.

Joint Accounts Exemption

FINRA proposes to integrate Incorporated NYSE Rule 431 Supplementary Material .10 into FINRA Rule 4210(e)(3) regarding joint accounts in which the carrying member or a partner or stockholder therein has an interest. The provision permits a member to seek an exemption under the FINRA Rule 9600 Series if the account is confined exclusively to transactions and positions in exempted securities.

Additional Requirements on Control and Restricted Securities and Relationship to FINRA Rule 4120 (Regulatory Notification and Business Curtailment)

FINRA proposes to adopt provisions from Incorporated NYSE Rule 431 pertaining to deductions from net capital on control and restricted securities, which are not contained in NASD Rule 2520.⁹ These provisions, which would be set forth in FINRA Rule 4210(e)(8)(C)(ii), (iii) and (v), require that a member make deductions from its net capital if it extends credit over specified thresholds, discussed below, on control and restricted securities, and it must take such deductions into account when determining if it has reached any of the financial triggers specified in FINRA Rule 4120.¹⁰ The proposed rule change also would make

⁹ See Incorporated NYSE Rule 431(e)(8)(C)(ii), (iii) and (v).

¹⁰ FINRA Rule 4120 is based on Incorporated NYSE Rules 325 and 326, which were referenced in Incorporated NYSE Rule 431(e)(8)(C)(ii), (iii) and (v).

conforming amendments to FINRA Rule 4120(a)(1)(F) and (c)(1)(F) (Regulatory Notification and Business Curtailment) to clarify that a member must take into account the special deductions from net capital set forth in FINRA Rule 4210(e)(8)(C) in determining its status under FINRA Rule 4120.

Day Trading

FINRA proposes to adopt Supplementary Material .30 and .60 from Incorporated NYSE Rule 431 regarding day trading in proposed FINRA Rule 4210(f)(8)(B). FINRA proposes to integrate Supplementary Material .60 from Incorporated NYSE Rule 431 in FINRA Rule 4210(f)(8)(B)(iii) to provide that the day-trading buying power for non-equity securities may be computed using the applicable special maintenance margin requirements pursuant to other provisions of the margin rule. In addition, FINRA proposes to adopt Supplementary Material .30 from Incorporated NYSE Rule 431 as FINRA Rule 4210(f)(8)(B)(iv)b. to provide that in the event that the member at which a customer seeks to open an account or resume day trading in an existing account, knows or has a reasonable basis to believe that the customer will engage in pattern day trading, then the minimum equity required (\$25,000) must be deposited in the account prior to commencement of day trading. FINRA also proposes to relocate paragraph (f)(8)(C) of NASD Rule 2520 into FINRA Rule 4210(f)(8)(B)(iii) that specifies that day trading deficiencies must be met within five business days of the trade date.

Portfolio Margining

FINRA proposes to amend FINRA Rule 4210(g)(5) to highlight to members that portfolio margin-eligible participants, in addition to being required to be approved to engage in uncovered short option contracts pursuant to FINRA Rule 2360, must be approved to engage in security futures transactions pursuant to FINRA Rule 2370.

Conforming Amendments

FINRA proposes to add the terms “approved market maker,” “market maker” and “market making” to FINRA Rule 4210(f)(10)(F) to conform to rule changes made by the NYSE.¹¹ FINRA also proposes amending the definitions of the same terms used in FINRA Rule 4210(e)(5)(A) and (f)(10)(E) for consistency purposes.

Clarifying and Technical Amendments

Finally, FINRA proposes to make several technical changes to the margin rule text to update terminology and similar clarifications. First, FINRA proposes to add definitions to FINRA Rule 4210(f)(2)(A) regarding “listed” and “OTC” options and employ such terms throughout FINRA Rule 4210(f)(2). FINRA is not proposing any substantive changes to the margin requirements for listed or over-the-counter options; rather, the proposed rule change would make the rule easier to read by creating such definitions and using the terms consistently throughout the rule text.

Second, in proposed FINRA Rule 4210(f)(2)(I)(iv), FINRA proposes several clarifications to terminology where no margin may be required if the specified options or warrants are carried “short” in the account of a customer, against an escrow agreement, and either are held in the account at the time the options or warrants are written, or received in the account promptly thereafter. The proposed rule change would clarify that with respect to such

¹¹ See Securities Exchange Act Release No. 59077 (December 10, 2008), 73 FR 76691 (December 17, 2008) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change by New York Stock Exchange LLC Amending Exchange Rule 104T to Make a Technical Amendment to Delete Language Relating to Orders Received by NYSE Systems and DMM Yielding; Clarifying the Duration of the Provisions of Rule 104T; Making Technical Amendments to Rule 98 and Rule 123E to Update Rule References for DMM Net Capital Requirements; Rescinding Paragraph (g) of Rule 123; and Making Conforming Changes to Certain Exchange Rules to Replace the Term “Specialist” with “DMM”; File No. SR-NYSE-2008-127).

options or warrants, an escrow agreement is used, in a form satisfactory to FINRA, issued by a third party custodian bank or trust company, and in compliance with the requirements of Rule 610 of The Options Clearing Corporation. The corresponding provisions in Incorporated NYSE Rule 431¹² used the terms “letter of guarantee” and “escrow receipt” while NASD Rule 2520 used the term “letter of guarantee.” While in this context such terms generally were used interchangeably, FINRA proposes to use the term “escrow agreement” to eliminate any potential confusion.¹³ The proposed rule change also would replace the term “guarantor” with the term “custodian” to more accurately reflect the third party’s role. In addition, the proposed rule change would revise the definition of what constitutes a qualified security by eliminating the reference to the list of Over-the-Counter Margin Stocks published by the Board of Governors of the Federal Reserve System as the Federal Reserve no longer publishes such a list.

Third, the proposed rule change would insert the term “aggregate” before exercise price throughout proposed FINRA Rule 4210(f)(2)(H) and (f)(2)(N) to clarify a calculation must be made in the strategies and spreads that are noted (i.e., offsets, reverse conversions, butterfly spread, etc.). Finally, the proposed rule change would make various non-substantive changes to reflect the formatting, presentation and style conventions used in the Consolidated FINRA Rulebook.

Daily Record of Margin Requirements – Incorporated NYSE Rule 432(a)

FINRA proposes to adopt Incorporated NYSE Rule 432(a) (Daily Record of Required Margin) as FINRA Rule 4220 in substantially the form it exists today. Incorporated NYSE Rule 432(a) sets forth the requirements for daily recordkeeping of initial and maintenance margin calls

¹² See Incorporated NYSE Rule 431(f)(2)(H)(iv).

¹³ Such approach also is consistent with the CBOE rules. See CBOE Rule 12.3(d).

that are issued pursuant to Regulation T and the margin rules. There is no corresponding NASD rule. FINRA believes that this is an important requirement to heighten FINRA's ability to monitor members' margin call practices. In addition, Incorporated NYSE Rule 432(b) prohibits a member from allowing a customer to make a practice of satisfying initial margin calls by the liquidation of securities. However, this provision is substantially similar to the provision in proposed FINRA Rule 4210(f)(7), except that the proposed FINRA rule provision does not contain the exception for omnibus accounts. Accordingly, FINRA proposes to eliminate Incorporated NYSE Rule 432(b) and modify paragraph (f)(7) of FINRA Rule 4210 to add that the prohibition on liquidations shall not apply to any account carried on an omnibus basis as prescribed by Regulation T.

Required Submissions of Requests for Extension of Time Under Regulation T and SEC Rule 15c3-3 – NASD Rule 3160 and Incorporated NYSE Rule 434

FINRA proposes to adopt NASD Rule 3160 (Extensions of Time Under Regulation T and SEC Rule 15c3-3) as FINRA Rule 4230 with one modification discussed below and delete the substantively similar Incorporated NYSE Rule 434 (Required Submission of Requests for Extensions of Time for Customers). NASD Rule 3160 and Incorporated NYSE Rule 434 set forth requirements governing members' requests for extensions of time, as permitted in accordance with Regulation T and SEC Rule 15c3-3(n). These rules provide that when FINRA is the designated examining authority for a member, requests for extensions of time must be submitted to FINRA for approval, in a format FINRA requires. In addition, NASD Rule 3160 requires each clearing member that submits extensions of time on behalf of broker-dealers for which it clears to submit a monthly report to FINRA that indicates overall ratios of requested

extensions of time to total transactions that have exceeded a percentage specified by FINRA.¹⁴

FINRA monitors the number of Regulation T and SEC Rule 15c3-3 extension requests for each firm to determine whether to impose prohibitions on further extensions of time.¹⁵

FINRA proposes to add a provision to proposed FINRA Rule 4230 to clarify that for the months when no broker-dealer for which a clearing member clears exceeds the extension of time ratio criteria (i.e., 2%), the clearing member must submit a report indicating such. FINRA had previously requested such submissions but believes the submissions are essential to ensure FINRA has a complete and accurate understanding of correspondent firm extension requests.

As stated in the notice, FINRA represented that it will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date will be no later than 180 days following Commission approval.

III. Commission Findings

After careful consideration of the proposal, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.¹⁶ In particular, the Commission finds that the

¹⁴ See Notice to Members 06-62 (November 2006). FINRA would retain the reporting threshold specified in Notice to Members 06-62 of requiring a report for all introducing or correspondent firms that have overall ratios of requests for extensions of time to total transactions for the month that exceed 2%. In the event FINRA adjusts the reporting threshold, or the limitation threshold stated in note 15 below, it would advise members of the new parameters in a Regulatory Notice.

¹⁵ See supra note 14. FINRA will continue to prohibit further extension of time requests for (1) introducing or correspondent firms that exceed a 3% ratio of the number of extension of time requests to total transactions for the month and (2) clearing firms that exceed a 1% ratio of extension of time requests to total transactions.

¹⁶ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

proposal is consistent with Section 15A(b)(6) of the Act,¹⁷ which requires, among other things, that FINRA's 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. The Commission believes the proposed rule change will further the purposes of the Act by, among other things, clarifying and streamlining the margin requirements applicable to its members, as well as rules addressing extension of time requests under Regulation T and Commission Rule 15c3-3 and daily record of required margin. The Commission therefore believes that it is appropriate and consistent with the Act for FINRA to adopt FINRA Rule 4210 (Margin Requirements), FINRA Rule 4220 (Daily Record of Required Margin) and FINRA Rule 4230 (Required Submissions for Requests for Extensions of Time under Regulation T and SEC Rule 15c3-3) in the Consolidated FINRA Rulebook.

¹⁷ 15 U.S.C. 78q-3(b)(6).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁸ that the proposed rule change (SR-FINRA-2010-024) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁹

Florence E. Harmon
Deputy Secretary

¹⁸ 15 U.S.C. 78s(b)(2).

¹⁹ 17 CFR 200.30-3(a)(12).