

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-62711; File No. SR-FINRA-2010-041)

August 12, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Amendments to FINRA Rule 2360 to Extend the Time to Submit a Contrary Exercise Advice and the Time for a Final Exercise Decision in the Event of a Modified Close of Trading

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 August 4, 2010, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by FINRA. FINRA has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,<sup>3</sup> which renders the proposal effective upon receipt of this filing by the Commission. 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 the Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA Rule 2360 (Options) to: (1) extend the time by which members must submit Contrary Exercise Advice (“CEA”) notices; (2) amend the time for a final exercise decision in the event of a modified close of trading; and (3) make certain changes to reorganize the rule text to clarify the rule requirements.

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

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

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

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, on the Commission's Web site at <http://www.sec.gov>, and at the Commission's Public Reference Room.

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

The purpose of the proposed rule change is to amend FINRA Rule 2360(b)(23)(A) to:

- (1) extend the time by which members must submit Contrary Exercise Advice ("CEA")<sup>4</sup> notices;
- (2) amend the time for a final exercise decision in the event of a modified close of trading; and
- (3) make certain changes to reorganize the rule text to clarify the rule requirements.

FINRA Rule 2360(b)(23)(A) contains special procedures that apply to the exercise of standardized options on the last business day before expiration. An option holder with an expiring standardized option may (1) take no action and allow automatic exercise determinations to be made in accordance with the Options Clearing Corporation's ("OCC") exercise-by-

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<sup>4</sup> Contrary Exercise Advices also are referred to as Expiring Exercise Declarations ("EED") in The Options Clearing Corporation's rules.

exception (“Ex-by-Ex”) procedures,<sup>5</sup> or (2) submit a CEA as specified below. A CEA is a communication to (i) not exercise an option that would be automatically exercised under OCC’s Ex-by-Ex procedure, or (ii) exercise an option that would not be automatically exercised under OCC’s Ex-by-Ex procedure.

FINRA proposes to relocate and revise the provisions from the current subparagraph (ii) regarding the deadline for option holders to inform members of exercise decisions and the deadline for members to submit CEAs indicating such decision into two separate subsections to improve readability. In new subsection (iii), FINRA provides (as currently provided in current subsection (ii)) that option holders have until 5:30 p.m. Eastern Time (“ET”) on the business day immediately prior to the expiration date to make a final exercise decision to exercise or not exercise an expiring option. In addition, FINRA clarifies that members may not accept exercise instructions for customer or non-customer accounts after 5:30 p.m. ET. This is not a new requirement but meant to highlight that this provision is still in effect.

The balance of current subparagraph (ii) regarding the deadline for members to submit CEAs indicating the option holders exercise decision is relocated to the end of new subparagraph (iv) after the explanation of the contents of CEAs. FINRA believes this improves the readability of the rule. In addition, FINRA proposes to extend the deadline for members to submit CEAs in certain instances. Currently, members have until 6:30 p.m. ET to submit a CEA for customer accounts. In addition, members have until 6:30 p.m. ET to submit a CEA for non-customer accounts if the member employs an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. FINRA proposes to extend these deadlines by one hour, from 6:30 p.m. ET to 7:30 p.m. ET. FINRA believes that granting

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<sup>5</sup> Under the Ex-by-Ex procedures an option will be automatically exercised if the option contract is in-the-money by a requisite amount.

members additional time to submit CEAs is necessary to address concerns raised by members that the existing deadline has raised issues regarding timely back-office processing. FINRA notes that the Ex-by-Ex threshold has changed from \$0.75 for customers (and \$0.25 for broker-dealers) to \$0.01 for all accounts. This decrease in the Ex-by-Ex threshold coupled with the increase in options trading volume in recent years has led to a larger number of CEAs and increased the burden on firms to process and submit instructions timely. The proposed additional one hour will address this concern by further enabling firms to more timely manage, process and submit CEAs.

FINRA does not propose to extend the CEA submission cut-off time for non-customer accounts of members that do not use electronic time stamps to record the submission of exercise instructions from option holders. Such CEAs must be manually submitted by the member by 5:30 p.m. ET.

FINRA also proposes two amendments to subparagraph (vii), re-numbered as subparagraph (viii), regarding the deadlines in the event a modified close of trading is announced. First, FINRA proposes to amend the deadline for option holders to make a final exercise decision for an expiring standardized option from 1 hour and 28 minutes following the modified time announced for the close of trading to 1 hour and 30 minutes following the modified closing time. The proposed rule change is consistent with the rules of the options exchanges, which were modified to correspond to the two-minute difference in trading time created by the change in the close of trading time from 4:02 p.m. to 4 p.m. ET.<sup>6</sup> Consistent with

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<sup>6</sup> See Securities Exchange Act Release Nos. 53519 (March 20, 2006), 71 FR 15229 (March 27, 2006) (SR-AMEX-2006-26); 53249 (February 7, 2006), 71 FR 8035 (February 15, 2006) (SR-PCX-2005-138); 53407 (March 3, 2006), 71 FR 12764 (March 13, 2006) (SR-PHLX-2006-12); 53439 (March 7, 2006), 71 FR 13643 (March 16, 2006) (SR-ISE-2006-11); and 53438 (March 7, 2006), 71 FR 13641 (March 16, 2006) (SR-CBOE-2006-19).

this modification, FINRA also proposes that members that do not employ an electronic submission procedure for exercise instructions would be required to submit a CEA within 1 hour and 30 minutes after the modified close of trading for its non-customer accounts rather than 1 hour and 28 minutes.

Second, FINRA proposes to modify re-numbered subparagraph (viii), which allows a member up to 2 hours and 28 minutes to submit a CEA in the event of a modified close of trading, by removing such provision and allowing a member to submit a CEA in such circumstances up to 7:30 p.m. ET. FINRA believes making uniform the submission deadlines on both regular and modified close expiration days provides for consistent regulation and prevents the possibility for error when determining what the CEA submission deadline is on any modified close expiration day. The initiative to address members' concern regarding the cut-off time for CEAs is industry-wide, and FINRA proposes these amendments to maintain consistency with the rules of the options exchanges.<sup>7</sup>

FINRA has filed the proposed rule change for immediate effectiveness. If the implementation date of the proposed rule change is more than 5 business days prior to the date of the next expiration Friday, i.e., the third Friday of the month ("Expiration Friday"),<sup>8</sup> FINRA will implement the proposed rule change so as to be effective for that Expiration Friday. If the implementation date of the proposed rule change is 5 business days or less prior to the date of the next Expiration Friday, FINRA will implement the rule change so as to be effective for the

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<sup>7</sup> See Securities Exchange Act Release No. 61710 (March 15, 2010), 75 FR 13636 (March 22, 2010) (Order Approving SR-ISE-2010-02). FINRA anticipates that the other options exchanges will propose similar rule changes.

<sup>8</sup> For example, Expiration Friday for August 2010 options will be August 20, 2010, Expiration Friday for September options will be September 17, 2010.

following Expiration Friday. FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>9</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 believes that the proposed rule change will foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities as set forth in Section 15A(b)(6) of the Act<sup>10</sup> by providing members an additional hour within which to complete the necessary processing of CEAs, will thereby decrease members' burden of processing an increasing number of CEAs and enable them to more easily manage and process these instructions. In addition, the proposed rule change is being made to maintain consistency with the rules of the options exchanges.<sup>11</sup>

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 Regarding the Proposed Rule Change Received from Members, Participants or Others

Written comments were neither solicited nor received.

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<sup>9</sup> 15 U.S.C. 78o-3(b)(6).

<sup>10</sup> 15 U.S.C. 78o-3(b)(6).

<sup>11</sup> See note 7.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>12</sup> and Rule 19b-4(f)(6) thereunder.<sup>13</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

### 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-2010-041 on the subject line.

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<sup>12</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>13</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. FINRA has satisfied this requirement.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2010-041. 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 Web site viewing and printing 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 publicly available. All submissions should refer to File Number SR-FINRA-2010-041 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>14</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).