

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-63391; File No. SR-FINRA-2010-063)

November 30, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Extend to July 16, 2011, the Pilot Period for FINRA Rule 4240 (Margin Requirements for Credit Default Swaps)

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 November 22, 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 substantially 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 Substance of the Proposed Rule Change

FINRA is proposing to extend to July 16, 2011, FINRA Rule 4240 (Margin Requirements for Credit Default Swaps) on an interim pilot program basis. FINRA Rule 4240, as approved by the SEC on May 22, 2009, will expire on November 30, 2010. The rule implements an interim pilot program with respect to margin requirements for transactions in credit default swaps executed by a member (regardless of the type of account in which the

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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).

transaction is booked), including those in which the offsetting matching hedging transactions are effected by the member in credit default swap contracts that are cleared through the central counterparty clearing services of the Chicago Mercantile Exchange.

The text of the proposed rule change is below. Proposed new language is underlined; proposed deletions are in brackets:

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4000. FINANCIAL AND OPERATIONAL RULES

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4200. MARGIN

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4240. Margin Requirements for Credit Default Swaps

(a) Effective Period of Interim Pilot Program

This Rule establishes an interim pilot program (“Interim Pilot Program”) with respect to margin requirements for any transactions in credit default swaps executed by a member (regardless of the type of account in which the transaction is booked), including those in which the offsetting matching hedging transactions (“matching transactions”) are effected by the member in contracts that are cleared through the central counterparty clearing services of the Chicago Mercantile Exchange (“CME”). The Interim Pilot Program shall automatically expire on [November 30, 2010] July 16, 2011. For purposes of this Rule, the term “credit default swap” (“CDS”) shall mean any “eligible credit default swap” as defined in Securities Act Rule 239T(d), as well as any other CDS that would otherwise meet such definition but for being subject to individual negotiation, and the term “transaction” shall include any ongoing CDS position.

(b) through (e) No Change.

••• Supplementary Material: -----

.01 No Change.

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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

On May 22, 2009, the Commission approved FINRA Rule 4240,<sup>4</sup> which implements an interim pilot program (the “Interim Pilot Program”) with respect to margin requirements for transactions in credit default swaps (“CDS”) executed by a member (regardless of the type of account in which the transaction is booked), including those in which the offsetting matching hedging transactions are effected by the member in credit default swap contracts that are cleared through the central counterparty clearing services of the Chicago Mercantile Exchange (“CME”).

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<sup>4</sup> See Securities Exchange Act Release No. 59955 (May 22, 2009), 74 FR 25586 (May 28, 2009) (Notice of Approval of Proposed Rule Change; File No. SR-FINRA-2009-012) (“Approval Order”).

On September 21, 2009, FINRA extended the implementation of Rule 4240 to November 30, 2010.<sup>5</sup>

As explained in the Approval Order, FINRA Rule 4240 is intended to be coterminous with certain Commission actions intended to address concerns arising from systemic risk posed by CDS, including, among others, risks to the financial system arising from the lack of a central clearing counterparty to clear and settle CDS.<sup>6</sup> Recently, the Commission has determined to extend the period for which certain of these actions are in effect.<sup>7</sup> FINRA believes it is

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<sup>5</sup> See Securities Exchange Act Release No. 60722 (September 25, 2009), 74 FR 50856 (October 1, 2010) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change; File No. SR-FINRA-2009-063).

<sup>6</sup> See 74 FR 25588 through 25589. In early 2009 the Commission enacted interim final temporary rules (the “interim final temporary rules”) providing enumerated exemptions under the federal securities laws for certain CDS to facilitate the operation of one or more central clearing counterparties in such CDS. See Securities Act Release No. 8999 (January 14, 2009), 74 FR 3967 (January 22, 2009) (Temporary Exemptions for Eligible Credit Default Swaps To Facilitate Operation of Central Counterparties To Clear and Settle Credit Default Swaps); Securities Act Release No. 9063 (September 14, 2009) (Extension of Temporary Exemptions for Eligible Credit Default Swaps To Facilitate Operation of Central Counterparties To Clear and Settle Credit Default Swaps). See also Securities Exchange Act Release No. 59578 (March 13, 2009), 74 FR 11781 (March 19, 2009) (Order Granting Temporary Exemptions in Connection with Request of Chicago Mercantile Exchange Inc. and Citadel Investment Group, L.L.C. Related to Central Clearing of Credit Default Swaps); Securities Exchange Act Release No. 59165 (December 24, 2008), 74 FR 133 (January 2, 2009) (Order Granting Temporary Exemptions for Broker-Dealers and Exchanges Effecting Transactions in Credit Default Swaps).

<sup>7</sup> See Securities Act Release No. 9158 (November 19, 2010), 75 FR 72260 (November 26, 2009) (Extension of Temporary Exemptions for Eligible Credit Default Swaps To Facilitate Operation of Central Counterparties To Clear and Settle Credit Default Swaps).

appropriate to extend the implementation of the Interim Pilot Program accordingly, to July 16, 2011.<sup>8</sup>

FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, such that FINRA can implement the proposed rule change immediately. The proposed rule change will expire on July 16, 2011. FINRA is proposing to implement the proposed rule change on November 30, 2010.

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 further the purposes of the Act because, consistent with the goals set forth by the Commission when it adopted the interim final temporary rules with respect to the operation of central counterparties to clear and settle CDS, the margin requirements set forth by the proposed rule change will help to stabilize the financial markets.

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

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<sup>8</sup> See Exhibit 5.

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

Written comments were neither solicited nor received.

### 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>10</sup> and Rule 19b-4(f)(6) thereunder.<sup>11</sup>

FINRA requests that the Commission waive the five-day pre-filing notice requirement specified in Rule 19b-4(f)(6)(iii) under the Act.<sup>12</sup> FINRA proposes to make the proposed rule change operative on November 30, 2010.

FINRA has requested that the Commission waive the 30-day operative delay, so that the proposed rule change may become operative upon filing. The Commission hereby grants FINRA's request and believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest.<sup>13</sup> This will allow the existing pilot program to continue without interruption and extend the benefits of a pilot program that the Commission

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<sup>10</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>11</sup> 17 CFR 240.19b-4(f)(6).

<sup>12</sup> 17 CFR 240.19b-4(f)(6)(iii). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of 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. The Commission has waived the five-day pre-filing period in this case.

<sup>13</sup> For the purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

approved and previously extended. For these reasons, the Commission designates the proposed rule change as effective and operative on November 30, 2010.

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-2010-063 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate 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-2010-063. 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 website (<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 website 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 a.m. and 3 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-2010-063 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).