4240. Margin Requirements for Credit Default Swaps

This version is valid from Jul 18, 2019 through Jul 19, 2020.
Amendments have been announced but are not yet effective. To view other versions open the versions tab on the right.

(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 held in an account at a member (regardless of the type of account in which the transaction is booked), including transactions that are effected by the member in contracts that are cleared through a clearing agency that provides central counterparty clearing services using a margin methodology the use of which has been approved by FINRA as announced in a Regulatory Notice. The Interim Pilot Program shall automatically expire on July 20, 2020. For purposes of this Rule, the term "credit default swap" ("CDS") shall include any product that is commonly known to the trade as a credit default swap and is a security-based swap as defined pursuant to Section 3(a)(68) of the Exchange Act or the rules and guidance of the SEC and its staff. The term "transaction" shall include any ongoing CDS position.

(b) Central Counterparty Clearing Arrangements

Any member, prior to establishing any clearing arrangement with respect to CDS transactions that makes use of any central counterparty clearing services provided by any clearing agency must notify FINRA in advance in writing, in such manner as may be specified by FINRA in a Regulatory Notice.

(c) Margin Requirements

(1) CDS Cleared Through a Clearing Agency Using a Margin Methodology the Use of Which Has Been Approved By FINRA

Members shall require as a minimum for computing customer or broker-dealer margin, with respect to any customer or broker-dealer transaction in CDS that is cleared through the central counterparty clearing facilities of a clearing agency using a margin methodology the use of which has been approved by FINRA as announced in a Regulatory Notice, the applicable margin pursuant to the rules of such clearing agency regardless of the type of account in which the transaction in CDS is booked. Members shall, based on the risk monitoring procedures and guidelines set forth in paragraph (d) of this Rule, determine whether the applicable clearing agency requirements are adequate with respect to their customer and broker-dealer accounts and the positions in those accounts and, where appropriate, increase such margin in excess of such minimum margin. For this purpose, members are permitted to use the margin requirements set forth in Supplementary Material .01 of this Rule.

The aggregate amount of margin the member collects from customers and broker-dealers for transactions in CDS must equal or exceed the aggregate amount of margin the member is required to post at the clearing agency with respect to those customer and broker-dealer transactions.

Transactions that are cleared through a clearing agency using a margin methodology the use of which has been approved by FINRA as announced in a Regulatory Notice are not subject to the provisions of paragraph (c)(2) of this Rule.

(2) CDS That Are Cleared on Central Counterparty Clearing Facilities That Do Not Use a Margin Methodology the Use of Which Has Been Approved By FINRA or That Settle Over-the-Counter ("OTC")

Unless otherwise permitted by FINRA in writing, members shall require, with respect to any transaction in CDS that makes use of central counterparty clearing facilities that do not use a margin methodology the use of which has been approved by FINRA as announced in a Regulatory Notice or that settle OTC, the applicable minimum margin as set forth in Supplementary Material .01 of this Rule regardless of the type of account in which the transaction in CDS is booked. However, members shall, based on the risk monitoring procedures and guidelines set forth in paragraph (d) of this Rule, determine whether such margin is adequate with respect to their customer and broker-dealer accounts and, where appropriate, increase such requirements.

In addition to requiring the applicable minimum margin as set forth pursuant to this paragraph (c)(2) (initial margin), the member shall collect daily from each customer or broker-dealer counterparty an amount at least equal to the member's current exposure, as defined in SEA Rule 15c3-1e(c)(4) (provided, however, that members not otherwise subject to SEA Rule 15c3-1e are not required to take into account paragraph (c)(4)(v)(G) of such Rule), arising from the daily mark to market of the CDS (variation margin).

(3) CDS That Are Held in an Account Subject To a CDS Portfolio Margining Program

In lieu of the requirements set forth in paragraphs (c)(1) and (c)(2) of this Rule, a member may require, with respect to CDS held in an account subject to an approved portfolio margining program, the amount of margin determined by the member's portfolio margin methodology, provided that, prior to margining CDS on a portfolio margin basis, the member shall notify FINRA in advance in writing of its intent to operate under the portfolio margin program.

(d) Risk Monitoring Procedures and Guidelines

Members shall monitor the risk of any customer or broker-dealer accounts with exposure to CDS and shall maintain a comprehensive written risk analysis methodology for assessing the potential risk to the member's capital over a specified range of possible market movements over a specified time period. For purposes of this Rule, members must employ the risk monitoring procedures and guidelines set forth in paragraphs (d)(1) through (8) of this Rule. The member must review, in accordance with the member's written procedures, at reasonable periodic intervals, the member's credit extension activities for consistency with the risk monitoring procedures and guidelines set forth in this Rule, and must determine whether the data necessary to apply the risk monitoring procedures and guidelines is accessible on a timely basis and information systems are available to adequately capture, monitor, analyze and report relevant data, including:

(1) obtaining and reviewing the required account documentation and financial information necessary for assessing the amount of credit to be extended to customers and broker-dealers;

(2) assessing the determination, review and approval of credit limits to each customer and broker-dealer, and across all customers and broker-dealers, engaging in CDS transactions;

(3) monitoring credit risk exposure to the member from CDS, including the type, scope and frequency of reporting to senior management;

(4) the use of stress testing of accounts containing CDS contracts in order to monitor market risk exposure from individual accounts and in the aggregate;

(5) managing the impact of credit extended related to CDS contracts on the member's overall risk exposure;

(6) determining the need to collect additional margin from a particular customer or broker-dealer, including whether that determination was based upon the creditworthiness of the customer or broker-dealer and/or the risk of the specific contracts;

(7) monitoring the credit exposure resulting from concentrated positions within both individual accounts and across all accounts containing CDS contracts; and

(8) maintaining sufficient margin in each customer and broker-dealer account to protect against the default of the largest individual exposure in the account as measured by computing the largest maximum possible loss (that is, the notional amount of the CDS less the estimated recovery given default).

(e) Concentrations

Unless otherwise permitted by FINRA in writing, where the current and maximum potential exposure, as defined in SEA Rule 15c3-1e(c)(4) (provided, however, that members not otherwise subject to SEA Rule 15c3-1e are not required to take into account paragraph (c)(4)(v)(G) of such Rule), with respect to the largest single name CDS across all accounts exceeds the member's tentative net capital, the member must take a capital charge equal to the aggregate margin requirement for such accounts on the positions in such single name CDS in accordance with the tables set forth in Supplementary Material .01 of this Rule. This capital charge may be reduced by the amount of excess margin held in each such counterparty account holding such exposure, on an account by account basis.

• • • Supplementary Material: ----------

.01 Margin Requirements for CDS. Unless otherwise permitted by FINRA in writing, the following customer and broker-dealer margin requirements shall apply, as appropriate, pursuant to paragraph (c) of this Rule. In addition to requiring the applicable minimum margin (initial margin) as set forth pursuant to this Supplementary Material, the member shall collect daily from each customer or broker-dealer counterparty an amount at least equal to the member's current exposure, as defined in SEA Rule 15c3-1e(c)(4) (provided, however, that members not otherwise subject to SEA Rule 15c3-1e are not required to take into account paragraph (c)(4)(v)(G) of such Rule), arising from the daily mark to market of the CDS (variation margin).

(a) Customer and Broker-Dealer Accounts That Are Short a CDS

The following table shall be used to determine the margin that a member must collect from a customer or broker-dealer that is short a single name debt security CDS contract (sold protection). The margin to be collected based upon the basis point spread over LIBOR of the

CDS contract as well as the maturity of that contract as a percentage of the notional amount shall be as follows:

Length of Time to Maturity of CDS Contract	Basis Point Spread					
	100 or below	101-300	301-400	401-500	501-699	700 and above
12 months & shorter	1.00%	2.00%	5.00%	7.50%	10.00%	15.00%
13-24 months	1.50%	3.50%	7.50%	10.00%	12.50%	17.50%
25-36 months	2.00%	5.00%	10.00%	12.50%	15.00%	20.00%
37-48 months	3.00%	6.00%	12.50%	15.00%	17.5%	22.50%
49-60 months	4.00%	7.00%	15.00%	17.50%	20.00%	25.00%
61-72 months	5.50%	8.50%	16.00%	20.00%	22.50%	27.50%
73-84 months	7.00%	10.00%	20.00%	22.50%	27.50%	30.00%
85-120 months	8.50%	15.00%	22.50%	25.00%	30.00%	40.00%
121 months & longer	10.00%	20.00%	25.00%	27.50%	35.00%	50.00%

For those CDS contracts where the underlying obligation is a narrow-based debt index, rather than a single name bond, the margin requirement shall be based upon a margin methodology using the member's internal models the use of which has been approved by FINRA.

(b) Accounts That Are Long a CDS

For customer or broker-dealer accounts that are long the CDS contracts (purchased protection), the margin to be collected shall be 50% of the above amounts.

(c) Accounts That Maintain Both Long and Short CDS

In instances where the customer or broker-dealer maintains both long and short CDS, the member may elect to collect 50% of the above margin requirements on the lesser of the long or short position within the same Bloomberg CDS sector (or, if the long and short positions are equal, the long position), provided those long and short positions are in the same spread and maturity bucket, plus the above margin requirements on the excess long or short position, if any.

If a customer or broker-dealer is long the bond and long a CDS contract on the same underlying obligor, margin needs to be collected only on the long bond position, provided that bond can be delivered against the long CDS contract, as prescribed pursuant to applicable FINRA margin rules.

In instances where the customer or broker-dealer is short the bond and short the CDS on the same underlying obligor, margin need only be collected on the short bond, as prescribed pursuant to applicable FINRA margin rules.

Amended by SR-FINRA-2019-016 eff. July 18, 2019.
Amended by SR-FINRA-2018-025 eff. July 18, 2018.
Amended by SR-FINRA-2017-019 eff. July 18, 2017.
Amended by SR-FINRA-2016-020 eff. July 18, 2016.
Amended by SR-FINRA-2015-013 eff. July 17, 2015.
Amended by SR-FINRA-2014-029 eff. June 23, 2014.
Amended by SR-FINRA-2013-030 eff. July 11, 2013.
Amended by SR-FINRA-2013-017 eff. Mar. 8, 2013.
Amended by SR-FINRA-2012-035 eff. July 13, 2012.
Amended by SR-FINRA-2012-015 eff. Mar. 7, 2012.
Amended by SR-FINRA-2012-014 eff. Jan. 17, 2012.
Amended by SR-FINRA-2011-034 eff. July 16, 2011.
Amended by SR-FINRA-2010-063 eff. Nov. 22, 2010.
Amended by SR-FINRA-2009-063 eff. Sep. 21, 2009.
Adopted by SR-FINRA-2009-012 eff. June 3, 2009.

Selected Notices: 09-30, 11-31.

‹ 4230. REQUIRED SUBMISSIONS FOR REQUESTS FOR EXTENSIONS OF TIME UNDER REGULATION T AND SEA RULE 15C3-3 UP 4300. OPERATIONS ›

VERSIONS

Jul 18, 2019 - Jul 19, 2020

4311. Carrying Agreements

The Rule | Notices

(a)(1) Unless otherwise permitted by FINRA, a member shall not enter into an agreement for the carrying, on an omnibus or fully disclosed basis, of any customer account in which securities transactions can be effected ("customer account" or "account"), unless such agreement is with a carrying firm that is a FINRA member. An introducing firm that acts as an intermediary for another introducing firm(s) for the purpose of obtaining clearing services from the carrying firm must notify such carrying firm of the existence of such arrangement(s) and the identity of the other introducing firm(s). Each such carrying agreement(s) shall identify and bind every direct and indirect recipient of clearing services as a party thereto.

(2) A carrying firm may enter into a carrying agreement(s) for the carrying of the customer accounts of a person other than a U.S. registered broker or dealer, subject to the conditions set forth in this Rule.

(b)(1) The carrying firm shall submit to FINRA for prior approval any agreement for the carrying of accounts, whether on an omnibus or fully disclosed basis, before such agreement may become effective. The carrying firm also shall submit to FINRA for prior approval any material changes to an approved carrying agreement before such changes may become effective.

(2) A carrying firm may use a standardized form of agreement that has been approved by FINRA pursuant to paragraph (b)(1) of this Rule, to enter into new carrying arrangements with other U.S. registered brokers or dealers, without the resubmission and re-approval of such agreement. However, a carrying firm must submit to FINRA for approval each carrying agreement that includes a party that is not a U. S. registered broker or dealer.

(3) As early as possible, but not later than 10 business days, prior to the carrying of any accounts of a new introducing firm (including the accounts of any introducing firm(s) for which a new or existing introducing firm is acting as an intermediary in obtaining clearing services from the carrying firm) the carrying firm shall submit to FINRA a notice identifying each such introducing firm by name and CRD number and shall include such additional information as FINRA may require.

(4) Each carrying firm shall conduct appropriate due diligence with respect to any new introducing firm relationship to assess the financial, operational, credit and reputational risk that such arrangement will have upon the carrying firm. FINRA, in its review of any arrangement, may in its discretion require specific items to be addressed by the carrying firm as part of such firm's due diligence requirement under this Rule. The carrying firm shall maintain a record, in accordance with the timeframes prescribed by SEA Rule 17a-4(b), of the due diligence conducted for each new introducing firm.

(c)(1) Each carrying agreement in which accounts are to be carried on a fully disclosed basis shall specify the responsibilities of each party to the agreement, including at a minimum the allocation of the responsibilities set forth in paragraphs (c)(1)(A) through (I) and (c)(2) of this Rule. The allocation of such responsibilities shall be subject to approval by FINRA pursuant to paragraph (b)(1) of this Rule.

(A) Opening and approving accounts.

(B) Acceptance of orders.

(C) Transmission of orders for execution.

(D) Execution of orders.

(E) Extension of credit.

(F) Receipt and delivery of funds and securities.

(G) Preparation and transmission of confirmations.

(H) Maintenance of books and records.

(I) Monitoring of accounts.

(2) Each carrying agreement in which accounts are to be carried on a fully disclosed basis shall expressly allocate to the carrying firm the responsibility for the safeguarding of funds and securities for the purposes of SEA Rule 15c3-3 and for preparing and transmitting statements of account to customers. However, the carrying firm may authorize the introducing firm to prepare and/or transmit statements of account to customers on the carrying firm's behalf with the prior written approval of FINRA.

(d) Each customer whose account is introduced on a fully disclosed basis shall be notified in writing upon the opening of the account of the existence of the carrying agreement and the responsibilities allocated to each respective party. The carrying firm shall be responsible for the content of such notification to the customer. The customer shall be notified promptly and in writing in the event of any change to any of the parties to the agreement or any material change to the allocation of responsibilities thereunder.

(e) Each carrying agreement shall expressly state that to the extent that a particular responsibility is allocated to one party, the other party or parties will supply to the responsible organization all appropriate data in their possession pertinent to the proper performance and supervision of that responsibility.

(f) A carrying agreement may authorize an introducing firm to issue negotiable instruments directly to its customers on the carrying firm's behalf, using instruments for which the carrying firm is the maker or drawer, provided that the parties comply with SEA Rule 15c3-3 and further that the introducing firm represents to the carrying firm in writing that such introducing firm maintains, and will enforce, supervisory policies and procedures with respect to the issuance of such negotiable instruments that are satisfactory to the carrying firm.

(g)(1) Each carrying agreement shall expressly authorize and direct the carrying firm to:

(A) furnish promptly to the introducing firm and the introducing firm's designated examining authority (or, if none, to its appropriate regulatory agency or authority) any written customer complaint received regarding the conduct of the introducing firm or firms and its associated persons; and

(B) notify the complaining customer, in writing, that it has received the complaint and that such complaint has been furnished to the introducing firm and its designated examining authority (or, if none, to its appropriate regulatory agency or authority).

(2) Upon a showing of good cause, FINRA, at its discretion, may exclude certain carrying firms from the requirements of paragraph (g)(1) in instances where the introducing firm is an affiliated entity of the carrying firm.

(h)(1) At the commencement of the agreement and annually thereafter, the carrying firm must furnish to each of its introducing firms a list of all reports (e.g., exception reports) available to assist the introducing firm with the responsibilities allocated to it pursuant to the carrying agreement. The introducing firm must promptly request of the carrying firm, in writing, those offered reports that it requires.

(2) No later than July 1 of each year, the carrying firm shall notify the introducing firm's chief executive and chief compliance officer(s) in writing of the list of reports offered to, requested by and supplied to the introducing firm as of the date of the notice. A copy of this written notice must at the same time be provided to the introducing firm's designated examining authority (or if none, to its appropriate regulatory agency or authority).

(3) The carrying firm shall maintain as part of its books and records those reports requested by and supplied to the introducing firm. The carrying firm may satisfy the requirements of this paragraph by furnishing, upon request of the introducing firm's designated examining authority (or if none, to its appropriate regulatory agency or authority):

(A) a re-created copy of the report originally produced; or

(B) the format of the report and the applicable data elements contained in the original report.

(4) Upon a showing of good cause, FINRA, at its discretion, may exclude certain carrying firms from the requirements of this paragraph (h) in instances where the introducing firm is an affiliated entity of the carrying firm.

(i) All carrying agreements shall require each introducing firm to maintain its proprietary and customer accounts, and the proprietary and customer accounts of any introducing firm for which it is acting as an intermediary in obtaining clearing services from the carrying firm, in such a manner as to enable the carrying firm and FINRA to specifically identify the proprietary and customer accounts belonging to each introducing firm. The requirements of this paragraph (i) shall apply to intermediary clearing arrangements that are established on or after February 20, 2006.

• • • Supplementary Material: ----------

.01 Material Changes. For purposes of paragraph (b)(1) of this Rule, material changes include, but are not limited to, changes to: (a) the allocation of responsibilities required by this Rule; (b) termination clauses applicable to the introducing firm; (c) any terms or provisions affecting the liability of the parties; and (d) the parties to the agreement (including, for example, the addition of a new party to the agreement, such as a "piggyback" arrangement, a new carrying firm or a new introducing firm, but not including a termination of the agreement).

.02 Notice of New Introducing Firm Arrangement. For purposes of the notice requirements of paragraph (b)(3) of this Rule, the carrying firm shall submit a questionnaire in such form as to be specified by FINRA in a Regulatory Notice, which questionnaire may be updated from time to time as FINRA deems necessary.

.03 Due Diligence. For purposes of paragraph (b)(4) of this Rule, the carrying firm's due diligence may include, without limitation, inquiry by the carrying firm into the introducing firm's business model and product mix, proprietary and customer positions, FOCUS and similar reports, audited financial statements and complaint and disciplinary history.

.04 Allocation of Responsibilities. For purposes of paragraphs (c)(1)(F) and (c)(2) of this Rule, members are reminded that receipt and delivery of customers' funds and securities and the safeguarding of such funds and securities must comply with the requirements of the SEC's financial responsibility rules, in particular SEA Rule 15c3-3, and applicable SEC guidance.

.05 Notice to Customers. For purposes of paragraph (d) of this Rule, notification to customers of a change to any of the parties to the carrying agreement is not required in instances where, consistent with applicable FINRA rules and the federal securities laws, such customers' accounts are being transferred pursuant to: (a) ACATS using an authorized Transfer Instruction Form (TIF); or (b) a process outside of ACATS where notification to customers is provided by means of an alternative mechanism such as affirmative or negative response letters.

Amended by SR-FINRA-2010-061 eff. Aug. 1, 2011.
Amended by SR-NASD-2005-058 eff. Feb. 20, 2006.
Amended by SR-NASD-97-76 eff. July 19, 1999.
Adopted by SR-NASD-93-46 eff. Apr. 15, 1994.

Selected Notices: 92-32, 93-50, 94-7; 97-79, 99-57, 05-72, 11-26.

‹ 4310. MEMBER AGREEMENTS AND CONTRACTS UP 4314. SECURITIES LOANS AND BORROWINGS ›

4314. Securities Loans and Borrowings

The Rule | Notices

(a) Disclosure of Parties' Capacity in Loan or Borrow Transactions

(1) A member that lends or borrows securities in the capacity of agent shall disclose such capacity to the other party (or parties) to the transaction.

(2) Prior to lending securities to or borrowing securities from a person that is not a member of FINRA, a member shall determine whether the other party is acting as principal or agent in such transaction.

(3) A member that is a party to a security loan or borrow transaction, where the other party to such transaction is acting as agent, shall maintain books and records that reflect:

(A) the details of the transaction with the agent; and

(B) each principal(s) on whose behalf the agent is acting and the details of each transaction therewith.

(b) Right to Liquidate Transaction

Each member that is a party to an agreement with another member providing for the loan and borrowing of securities shall have the right to liquidate such transaction whenever the other party to such transaction:

(1) applies for or consents to, or is the subject of an application for, the appointment of or the taking of possession by a receiver, custodian, trustee, or liquidator of itself or of all or a substantial part of its property;

(2) admits in writing its inability, or becomes generally unable, to pay its debts as such debts become due;

(3) makes a general assignment for the benefit of its creditors; or

(4) files, or has filed against it, a petition under Title 11 of the United States Code, or has filed against it an application for a protective decree under Section 5 of the Securities Investor Protection Act of 1970 ("SIPA"), unless the right to liquidate such transaction is stayed, avoided, or otherwise limited by an order authorized under the provisions of SIPA or any statute administered by the SEC.

(c) Written Agreement with Non-Members

No member shall lend or borrow any security to or from any person that is not a member of FINRA, except pursuant to a written agreement, which may consist of the exchange of contract confirmations, that confers upon such member the contractual right to liquidate such transaction because of a condition of the kind specified in paragraph (b) of this Rule.

• • • ***Supplementary Material:*** ----------

.01 Definition of Agreement. For purposes of this Rule, an agreement for the loan and borrowing of securities shall mean a securities contract or other agreement, including related terms, for the transfer of securities against the transfer of funds, securities, or other collateral, with a simultaneous agreement by the transferee to transfer to the transferor against the transfer of funds, securities, or other collateral, upon notice, at a date certain, or upon demand, the same or substituted securities.

.02 Disclosure of Capacity. A member may satisfy its disclosure obligation in paragraph (a)(1) of this Rule by, among other things, providing specific disclosure of its capacity as agent in the written agreement between the parties or in the individual confirmations of each security exchanged between the parties for each loan and borrow transaction.

.03 Details of Transactions with Parties. For purposes of this Rule, a member shall create and maintain records for each security loan or borrow transaction in accordance with the requirements of SEA Rules 17a-3 and 17a-4. For purposes of paragraph (a)(3) of this Rule, when entering into a security loan or borrow transaction with a party that is acting as agent on behalf of another principal(s), the member shall maintain a record of the details of each security loan or borrow with the agent, identifying the specific security and quantity loaned or borrowed, the contract value and the type and description of the collateral provided to the agent. In addition, the member's records shall reflect the quantity of securities loaned or borrowed from each principal on whose behalf the agent is acting and the amount and description of the collateral allocated to each such principal.

.04 Compliance with Rule 4330 When Borrowing Securities from a Customer. When a member borrows securities from a customer, the member also is subject to Rule 4330(b)(2)(B)(ii), which requires members to provide disclosures to customers regarding the risks and financial impact associated with the customer's loan(s) of securities. Such written notice shall include a disclosure of the right of the member to liquidate the borrow transactions with the customer, as provided by paragraph (b) of this Rule.

.05 Compliance with SEA Rule 15c3-3. For purposes of paragraph (c) of this Rule, each member subject to the provisions of SEA Rule 15c3-3 that borrows securities from a customer (as defined in said rule) shall comply with the provisions thereof relating to the requirements for a written agreement between the borrowing member and the lending customer.

Amended by SR-FINRA-2013-035 eff. May 1, 2014.
Adopted by SR-NYSE-84-11 eff. March 20, 1985.

Selected Notice: 14-05

‹ 4311. CARRYING AGREEMENTS UP 4320. SHORT SALE DELIVERY REQUIREMENTS ›

4320. Short Sale Delivery Requirements

(a) If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in a non-reporting threshold security for 13 consecutive settlement days, the participant shall immediately thereafter close out the fail to deliver position by purchasing securities of like kind and quantity.

(1) *Provided, however*, if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency for thirty-five consecutive settlement days in a non-reporting threshold security that was sold pursuant to SEC Rule 144, the participant shall immediately thereafter close out the fail to deliver position in the security by purchasing securities of like kind and quantity. The requirements in paragraph (b) shall apply to all such fails to deliver that are not closed out in conformance with this paragraph (a)(1).

(b) If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in a non-reporting threshold security for 13 consecutive settlement days (or 35 consecutive settlement days if entitled to rely on paragraph (a)(1)), the participant and any broker or dealer for which it clears transactions, including any market maker that would otherwise be entitled to rely on the exception provided in paragraph (b)(2)(iii) of Rule 203 of SEC Regulation SHO, may not accept a short sale order in the non-reporting threshold security from another person, or effect a short sale in the non-reporting threshold security for its own account, without borrowing the security or entering into a bona-fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.

(c) If a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or for which it is responsible for settlement, based on such broker or dealer's short position, then the provisions of this Rule relating to such fail to deliver position shall apply to the portion of the fail to deliver position allocated to such registered broker or dealer, and not to the participant.

(d) A participant of a registered clearing agency shall not be deemed to have fulfilled the requirements of this Rule where the participant enters into an arrangement with another person to purchase securities as required by this Rule, and the participant knows or has reason to know that the other person will not deliver securities in settlement of the purchase.

(e) For the purposes of this Rule, the following terms shall have the meanings below:

(1) the term "market maker" has the same meaning as in Section 3(a)(38) of the Exchange Act.

(2) the term "non-reporting threshold security" means any equity security of an issuer that is not registered pursuant to Section 12 of the Exchange Act and for which the issuer is not required to file reports pursuant to Section 15(d) of the Exchange Act:

(A) for which there is an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more and for which on each settlement day during the five consecutive settlement day period, the reported last sale during normal market hours for the security on that settlement day that would value the aggregate fail to deliver position at $50,000 or more, provided that if there is no reported last sale on a particular settlement day, then the price used to value the position on such settlement day would be the previously reported last sale; and

(B) is included on a list published by FINRA.

A security shall cease to be a non-reporting threshold security if the aggregate fail to deliver position at a registered clearing agency does not meet or exceed either of the threshold tests specified in paragraph (e)(2)(A) of this Rule for five consecutive settlement days.

(3) the term "participant" means a participant as defined in Section 3(a)(24) of the Exchange Act, that is a FINRA member.

(4) the term "registered clearing agency" means a clearing agency, as defined in Section 3(a)(23)(A) of the Exchange Act, that is registered with the SEC pursuant to Section 17A of the Exchange Act.

(5) the term "settlement day" means any business day on which deliveries of securities and payments of money may be made through the facilities of a registered clearing agency.

(f) Pursuant to the Rule 9600 Series, the staff, for good cause shown after taking into consideration all relevant factors, may grant an exemption from the provisions of this Rule, either unconditionally or on specified terms and conditions, to any transaction or class of transactions,

or to any security or class of securities, or to any person or class of persons, if such exemption is consistent with the protection of investors and the public interest.

Amended by SR-FINRA-2010-028 eff. Oct. 15, 2010.
Amended by SR-FINRA-2007-013 eff. Oct. 15, 2007.
Amended by SR-NASD-2006-071 eff. July 3, 2006.
Amended by SR-NASD-2004-044 eff. July 3, 2006.
Amended by SR-NASD-2004-175 eff. Jan. 3, 2005.
Amended by SR-NASD-97-28 eff. Aug. 7, 1997.
Deleted and replaced with former Appendix B by SR-NASD-93-48 eff. Mar. 8, 1994.
Added eff. Sept. 24, 1973.

Selected Notices: 73-05, 73-45, 73-54, 73-67, 06-28, 07-45, 10-35.

‹ 4314. SECURITIES LOANS AND BORROWINGS UP 4330. CUSTOMER PROTECTION — PERMISSIBLE USE OF CUSTOMERS' SECURITIES ›

4330. Customer Protection — Permissible Use of Customers' Securities

The Rule | Notices

(a) Authorization to Lend Customers' Margin Securities

No member shall lend securities that are held on margin for a customer and that are eligible to be pledged or loaned, unless such member shall first have obtained a written authorization from such customer permitting the lending of such securities.

(b) Requirements for Borrowing of Customers' Fully Paid or Excess Margin Securities

(1) A member that borrows fully paid or excess margin securities carried for the account of any customer shall:

(A) comply with the requirements of SEA Rule 15c3-3;

(B) comply with the requirements of Section 15(e) of the Exchange Act; and

(C) notify FINRA, in such manner and format as FINRA may require, at least 30 days prior to first engaging in such securities borrows.

(2) Prior to first entering into securities borrows with a customer pursuant to paragraph (b)(1) of this Rule, a member shall:

(A) have reasonable grounds for believing that the customer's loan(s) of securities are appropriate for the customer. In making this determination, the member shall exercise reasonable diligence to ascertain the essential facts relative to the customer, including, but not limited to, the customer's financial situation and needs, tax status, investment objectives, investment time horizon, liquidity needs, risk tolerance and any other information the customer may disclose to the member or associated person in connection with entering such securities loans.

(B) provide the customer, in writing (which may be electronic), with the following:

(i) clear and prominent notice stating that the provisions of the Securities Investor Protection Act of 1970 may not protect the customer with respect to the customer's securities loan transaction and that the collateral delivered to the customer may constitute the only source of satisfaction of the member's obligation in the event the member fails to return the securities; and

(ii) disclosures regarding the customer's rights with respect to the loaned securities, and the risks and financial impact associated with the customer's loan(s) of securities, including, but not limited to:

a. loss of voting rights;

b. the customer's right to sell the loaned securities and any limitations on the customer's ability to do so, if applicable;

c. the factors that determine the amount of compensation received by the member and its associated persons in connection with the use of the securities borrowed from the customer;

d. the factors that determine the amount of compensation (e.g., interest rate) to be paid to the customer and whether or not such compensation can be changed by the member under the terms of the borrow agreement;

e. the risks associated with each type of collateral provided to the customer;

f. that the securities may be "hard-to-borrow" because of short-selling or may be used to satisfy delivery requirements resulting from short sales;

g. potential tax implications, including payments deemed cash-in-lieu of dividend paid on securities while on loan; and

h. the member's right to liquidate the transaction because of a condition of the kind specified in Rule 4314(b).

(3) A member that is subject to paragraph (b)(1) of this Rule shall create and maintain records evidencing the member's compliance with the requirements of paragraph (b)(2) of this Rule. Such records shall be maintained in accordance with the requirements of SEA Rule 17a-4(a).

• • • ***Supplementary Material:*** **----------**

.01 Definitions. For purposes of this Rule, the definitions contained in SEA Rule 15c3-3 shall apply.

.02 Authorization to Lend Customers' Margin Securities. For purposes of paragraph (a) of this Rule, members may use a single customer account agreement/margin agreement/loan consent signed by a customer as written authorization to permit the lending of a customer's margin eligible securities in lieu of obtaining a separate written authorization; provided such customer account agreement/margin agreement/loan consent includes clear and prominent disclosure that the firm may lend either to itself or others any securities held by the customer in its margin account.

.03 Notification to FINRA. FINRA, upon receipt of a member's written notification pursuant to paragraph (b)(1)(C) of this Rule, may request such additional information as it may deem necessary to evaluate compliance with SEA Rule 15c3-3, Section 15(e) of the Exchange Act and other applicable FINRA rules or federal securities laws or rules. Examples of additional information include, but are not limited to:

(a) the written agreement authorizing such borrowing of securities, which shall reflect the material terms of the arrangement;

(b) the types of customers that are parties to such securities borrows;

(c) the types of accounts used to effect the securities borrows (i.e., whether the subject securities are maintained in customers' cash or margin or other accounts);

(d) the types of collateral provided to customers in connection with such securities borrows, the frequency of marking to market of the collateral and the custody arrangements for such collateral;

(e) the operational and recordkeeping processes related to such securities borrows;

(f) the rebates paid/received in connection with such securities borrows and any other compensation arrangements related thereto;

(g) the procedures for handling customers' requests to sell the securities subject to such borrows; and

(h) disclosures made to customers.

.04 Appropriateness of Customer's Loan(s) of Securities. The member borrowing a customer's fully paid or excess margin securities is responsible for making the determination regarding the appropriateness of such borrow from a customer required by paragraph (b)(2)(A) of this Rule. However, in making that determination, when the member has entered into a carrying agreement with an introducing member, pursuant to Rule 4311, the member may rely on the representations of the introducing member that has a customer relationship with the lender.

.05 Appropriateness Determination for Institutional Customers. A member may fulfill the obligation set forth in paragraph (b)(2)(A) of this Rule for an institutional account, as defined in Rule 4512(c), by complying with the requirements of Rule 2111(b).

.06 Notification to FINRA of Pre-existing Fully Paid or Excess Margin Securities Borrows and Disclosures to Customers. Members with any existing fully paid or excess margin securities borrows with customers as of May 1, 2014 shall notify FINRA in writing, in such manner and format as FINRA may require, of such borrows within 30 days from May 1, 2014. Further, such members shall provide such customers with the disclosures required by paragraph (b)(2)(B) of this Rule within 180 days of May 1, 2014.

Amended by SR-FINRA-2013-035 partially effective May 1, 2014 and fully effective October 28, 2014.
Amended eff. March 17, 1983.
Amended eff. December 12, 1974.
Amended eff. October 18, 1972.
Amended eff. March 1, 1972.
Amended eff. December 19, 1968.

Selected Notice: 14-05

‹ 4320. SHORT SALE DELIVERY REQUIREMENTS UP 4340. CALLABLE SECURITIES ›

VERSIONS

Oct 28, 2014 onwards

4340. Callable Securities

The Rule | Notices

(a) Allocation Procedures and Customer Notice

Each member that has in its possession or under its control any security which, by its terms, may be called or redeemed prior to maturity, shall:

(1) establish and make available on the member's website procedures by which it will allocate among its customers, on a fair and impartial basis, the securities to be redeemed or selected as called in the event of a partial redemption or call; and

(2) provide written notice (which may be electronic) to new customers at the opening of an account, and all customers at least once every calendar year, of the manner in which they may access the allocation procedures on the member's website and that, upon a customer's request, the member will provide hard copies of the allocation procedures to the customer.

(b) Favorable Redemptions

Where redemption of callable securities is made on terms that are favorable to the called parties, a member shall not allocate the securities to any account in which it or its associated persons have an interest until all other customers' positions in such securities have been satisfied.

(c) Unfavorable Redemptions

Where the redemption of callable securities is made on terms that are unfavorable to the called parties, a member shall not exclude its positions or those of its associated persons (including those persons performing solely clerical and ministerial functions) from the pool of the securities eligible to be called.

• • • ***Supplementary Material:*** **----------**

.01 Definition of Associated Person; Clerical and Ministerial Functions. The term "associated person" as used in this Rule shall have the meaning provided in Section 3(a)(18) of the Exchange Act, which expressly excludes, for certain purposes, any person associated with the member whose functions are solely clerical or ministerial (referred to as "clerical and ministerial associated persons"). With respect to a redemption made on terms that are favorable to the called parties, for purposes of paragraph (b) of this Rule, a member may include the accounts of clerical and ministerial associated persons in the pool of the securities eligible to be called. With respect to a redemption made on terms that are unfavorable to the called parties, for purposes of paragraph (c) of this Rule, a member shall not exclude the accounts of clerical and ministerial associated persons from the pool of the securities eligible to be called.

.02 Allocations of Partial Redemptions or Calls. For purposes of paragraph (a)(1) of this Rule, a member's procedures may include the use of an impartial lottery system, acting on a pro-rata basis, or such other means as will achieve a fair and impartial allocation of the partially redeemed or called securities.

.03 Accounts of an Introducing Member and its Associated Persons. Where an introducing member is a party to a carrying agreement with another member that is conducting an allocation pursuant to paragraph (a) of this Rule, any accounts in which the introducing member or its associated persons have an interest shall be subject to paragraphs (b) and (c) of this Rule. The introducing member also shall identify such accounts to the member conducting the allocation.

Adopted by SR-FINRA-2013-035 eff. May 1, 2014.

Selected Notice: 14-05

‹ 4330. CUSTOMER PROTECTION — PERMISSIBLE USE OF CUSTOMERS' SECURITIES UP 4360. FIDELITY BONDS ›

4360. Fidelity Bonds

The Rule | Notices

(a) General Provision

(1) Each member required to join the Securities Investor Protection Corporation shall maintain blanket fidelity bond coverage which provides against loss and has Insuring Agreements covering at least the following:

(A) Fidelity

(B) On Premises

(C) In Transit

(D) Forgery and Alteration

(E) Securities

(F) Counterfeit Currency

(2) The fidelity bond must include a cancellation rider providing that the insurance carrier will use its best efforts to promptly notify FINRA in the event the bond is cancelled, terminated or substantially modified.

(3) A member's fidelity bond must provide for per loss coverage without an aggregate limit of liability.

(b) Minimum Required Coverage

(1) A member with a net capital requirement of less than $250,000 must maintain minimum fidelity bond coverage for all Insuring Agreements required by paragraph (a) of this Rule of the greater of (A) 120% of the member's required net capital under SEA Rule 15c3-1 or (B) $100,000. A member with a net capital requirement of $250,000 or more must maintain minimum fidelity bond coverage for all Insuring Agreements required by paragraph (a) of this Rule in accordance with the following table:

Net Capital Requirement under SEA Rule 15c3-1	Minimum Coverage
250,000 – 300,000	600,000
300,001 – 500,000	700,000
500,001 – 1,000,000	800,000
1,000,001 – 2,000,000	1,000,000
2,000,001 – 3,000,000	1,500,000
3,000,001 – 4,000,000	2,000,000
4,000,001 – 6,000,000	3,000,000
6,000,001 – 12,000,000	4,000,000
12,000,001 and above	5,000,000

(2) At a minimum, a member must maintain fidelity bond coverage for any person associated with the member, except directors or trustees who are not performing acts within the scope of the usual duties of an officer or employee.

(3) Any defense costs for covered losses must be in addition to the minimum coverage requirements as set forth in paragraph (b)(1) of this Rule.

(c) Deductible Provision

A provision may be included in a fidelity bond to provide for a deductible of up to 25% of the coverage purchased by a member. Any deductible amount elected by the member that is greater than 10% of the coverage purchased by the member must be deducted from the member's net worth in the calculation of its net capital for purposes of SEA Rule 15c3-1. If the member is a subsidiary of another FINRA member, this amount may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

(d) Annual Review of Coverage

(1) A member, including a member that signs a multi-year insurance policy, shall, annually as of the yearly anniversary date of the issuance of the fidelity bond, review the adequacy of its coverage and make any required adjustments, as set forth in paragraphs (d)(2) and (d)(3) of this Rule.

(2) A member's highest net capital requirement during the preceding 12-month period, based on the applicable method of computing net capital (dollar minimum, aggregate indebtedness or alternative standard), shall be used as the basis for determining the member's required minimum fidelity bond coverage for the succeeding 12-month period. For the purpose of this paragraph, the "preceding 12-month period" shall include the 12-month period that ends 60 days before the yearly anniversary date of a member's fidelity bond.

(3) A member that has only been in business for one year and elected the aggregate indebtedness ratio for calculating its net capital requirement may use, solely for the purpose of determining the adequacy of its fidelity bond coverage for its second year, the 15 to 1 ratio of aggregate indebtedness to net capital in lieu of the 8 to 1 ratio (required for broker-dealers in their first year of business) to calculate its net capital requirement. Notwithstanding the above, such member shall not carry less minimum bonding coverage in its second year than it carried in its first year.

(e) Notification of Change

A member shall immediately advise FINRA in writing if its fidelity bond is cancelled, terminated or substantially modified.

(f) Exemptions

(1) The requirements of this Rule shall not apply to:

(A) members that maintain a fidelity bond as required by a national securities exchange, registered with the SEC under Section 6 of the Exchange Act, provided that the member is in good standing with such national securities exchange and the fidelity bond requirements of such exchange are equal to or greater than the requirements of this Rule; and

(B) members whose business is solely that of a Designated Market Maker, Floor broker or registered Floor trader and who does not conduct business with the public.

(2) Any member may apply for an exemption, pursuant to the Rule 9600 Series, from the requirements of paragraphs (d)(2) and (d)(3) of this Rule. An exemption may be granted, at the discretion of FINRA, upon a showing of good cause, including a substantial change in the circumstances or nature of the member's business that would result in a lower net capital requirement.

• • • Supplementary Material: ----------

.01 Definitions. For purposes of this Rule, the term "substantially modified" shall mean any change in the type or amount of fidelity bonding coverage, or in the exclusions to which the bond is subject, or any other change in the bond such that it no longer complies with the requirements of this Rule.

.02 Alternative Coverage. A member that does not qualify for blanket fidelity bond coverage as required by paragraph (a)(3) of this Rule shall maintain substantially similar fidelity bond coverage in compliance with all other provisions of this Rule, provided that the member maintains written correspondence from two insurance providers stating that the member does not qualify for the coverage required by paragraph (a)(3) of this Rule. The member must retain such correspondence for the period specified by SEA Rule 17a-4(b)(4).

Amended by SR-FINRA-2010-059 eff. Jan. 1, 2012.
Amended by SR-NASD-98-33 eff. Sept. 15, 1998.
Deleted and replaced with former Appendix C by SR-NASD-93-48 eff. Mar. 8, 1994.
Amended by SR-NASD-82-14 eff. Nov. 19, 1982.
Amended eff. July 11, 1979.
Added eff. Mar. 15, 1974.

Selected Notices: 73-02, 73-75, 74-15, 75-26, 76-19, 78-02, 78-15, 79-25, 79-26, 82-40, 82-58, 83-56, 11-21.

‹ 4340. CALLABLE SECURITIES UP 4370. BUSINESS CONTINUITY PLANS AND EMERGENCY CONTACT INFORMATION ›

4370. Business Continuity Plans and Emergency Contact Information

The Rule | Notices

(a) Each member must create and maintain a written business continuity plan identifying procedures relating to an emergency or significant business disruption. Such procedures must be reasonably designed to enable the member to meet its existing obligations to customers. In addition, such procedures must address the member's existing relationships with other broker-dealers and counter-parties. The business continuity plan must be made available promptly upon request to FINRA staff.

(b) Each member must update its plan in the event of any material change to the member's operations, structure, business or location. Each member must also conduct an annual review of its business continuity plan to determine whether any modifications are necessary in light of changes to the member's operations, structure, business, or location.

(c) The elements that comprise a business continuity plan are flexible and may be tailored to the size and needs of a member. Each plan, however, must at a minimum, address:

(1) Data back-up and recovery (hard copy and electronic);

(2) All mission critical systems;

(3) Financial and operational assessments;

(4) Alternate communications between customers and the member;

(5) Alternate communications between the member and its employees;

(6) Alternate physical location of employees;

(7) Critical business constituent, bank, and counter-party impact;

(8) Regulatory reporting;

(9) Communications with regulators; and

(10) How the member will assure customers' prompt access to their funds and securities in the event that the member determines that it is unable to continue its business.

Each member must address the above-listed categories to the extent applicable and necessary. If any of the above-listed categories is not applicable, the member's business continuity plan need not address the category. The member's business continuity plan, however, must document the rationale for not including such category in its plan. If a member relies on another entity for any one of the above-listed categories or any mission critical system, the member's business continuity plan must address this relationship.

(d) Members must designate a member of senior management to approve the plan and he or she shall be responsible for conducting the required annual review. The member of senior management must also be a registered principal.

(e) Each member must disclose to its customers how its business continuity plan addresses the possibility of a future significant business disruption and how the member plans to respond to events of varying scope. At a minimum, such disclosure must be made in writing to customers at account opening, posted on the member's Web site (if the member maintains a Web site), and mailed to customers upon request.

(f)(1) Each member shall report to FINRA, via such electronic or other means as FINRA may specify, prescribed emergency contact information for the member. The emergency contact information for the member includes designation of two associated persons as emergency contact persons. At least one emergency contact person shall be a member of senior management and a registered principal of the member. If a member designates a second emergency contact person who is not a registered principal, such person shall be a member of senior management who has knowledge of the member's business operations. A member with only one associated person shall designate as a second emergency contact person an individual, either registered with another firm or nonregistered, who has knowledge of the member's business operations (e.g., the member's attorney, accountant, or clearing firm contact).

(2) Each member must promptly update its emergency contact information, via such electronic or other means as FINRA may specify, in the event of any material change. With respect to the designated emergency contact persons, each member must identify, review, and, if

necessary, update such designations in the manner prescribed by Rule 4517.

(g) For purposes of this Rule, the following terms shall have the meanings specified below:

(1) "Mission critical system" means any system that is necessary, depending on the nature of a member's business, to ensure prompt and accurate processing of securities transactions, including, but not limited to, order taking, order entry, execution, comparison, allocation, clearance and settlement of securities transactions, the maintenance of customer accounts, access to customer accounts and the delivery of funds and securities.

(2) "Financial and operational assessment" means a set of written procedures that allow a member to identify changes in its operational, financial, and credit risk exposures.

Amended by SR-FINRA-2015-004 eff. Feb. 12, 2015.
Amended by SR-FINRA-2009-036 eff. Dec. 14, 2009.
Amended by SR-NASD-2007-034 eff. Dec. 31, 2007.
Adopted by SR-NASD-2002-108 eff. Aug. 11, 2004 (Clearing Firms), Sep. 10, 2004 (Introducing Firms).

Selected Notices: 04-37, 07-42, 09-60.

‹ 4360. FIDELITY BONDS UP 4380. MANDATORY PARTICIPATION IN FINRA BC/DR TESTING UNDER REGULATION SCI ›

VERSIONS

Feb 12, 2015 onwards

4380. Mandatory Participation in FINRA BC/DR Testing Under Regulation SCI

The Rule | Notices

(a) In accordance with Rule 1004 of SEC Regulation SCI, FINRA will designate members that will be required to participate in FINRA's periodic, scheduled testing of its business continuity and disaster recovery (BC/DR) plan. FINRA will do so according to established criteria that are designed to ensure participation by those members that FINRA reasonably determines are, taken as a whole, the minimum necessary for the maintenance of fair and orderly markets in the event of the activation of its BC/DR plan. FINRA's criteria will consider volume of activity on a FINRA market system over a specified period of time. FINRA will communicate to members its criteria for designation under this Rule, and any changes to such criteria, on a prospective basis by Regulatory Notice.

(b) The testing of FINRA's BC/DR plan referred to in this Rule will occur at least once every twelve months. Such testing will include functional and performance testing of the operation of FINRA's BC/DR plan. FINRA will notify members that are designated to participate in BC/DR testing under this Rule at least 90 days prior to the scheduled test date.

(c) Members that are designated pursuant to this Rule shall be required to fulfill, within the time frames established by FINRA, certain testing requirements that FINRA determines are necessary and appropriate. Members may also be required to satisfy related reporting requirements, for example, reporting the results of the member's participation in testing under this Rule, as determined by FINRA.

Adopted by SR-FINRA-2015-046 eff. Nov. 3, 2015.

Selected Notice: 15-43

‹ 4370. BUSINESS CONTINUITY PLANS AND EMERGENCY CONTACT INFORMATION UP 4500. BOOKS, RECORDS AND REPORTS ›