

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57775; File No. SR-FINRA-2007-035)

May 5, 2008

Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 Relating to Options Supervision Requirements

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 18, 2007, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“Commission”) and amended on April 17, 2008³ the proposed rule change as described in Items I and II below, which Items have been substantially prepared by FINRA. This order provides notice of the proposed rule change as modified by Amendment No. 1 and approves the proposed rule change as amended on an accelerated basis.

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

FINRA is proposing to amend NASD Rule 1022 (Categories of Principal Registration), NASD Rule 2220 (Options Communications with the Public) and NASD Rule 2860 (Options) to eliminate the requirement for separate designations of Senior Registered Options Principal (“SROP”) and Compliance Registered Options Principal

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 to SR-FINRA-2007-035 replaced and superseded the original rule filing filed on December 18, 2007.

("CROP") and require a member to integrate the responsibility for supervision of its public customer options business into its overall supervisory and compliance program.

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

* * * * *

1022. Categories of Principal Registration

(a) through (e) No Change.

(f) Limited Principal – Registered Options and Security Futures

(1) Every member of [the Association]NASD that is engaged in, or that intends to engage in transactions in security futures or [put or call] options with the public shall have at least one Registered Options and Security Futures Principal who shall have satisfied the requirements of this subparagraph. [As to options transactions, each member shall also designate a Senior Registered Options Principal and a Compliance Registered Options Principal in accordance with the provisions of Rule 2860(b)(20) and identify such persons to the Association.] Every person engaged in the supervision of options and security futures sales practices, including a person designated pursuant to Rule 3010(a)(2) [the management of the day-to-day options or security futures activities of a member] shall [also] be registered as a Registered Options and Security Futures Principal.

(2) through (5) No Change.

(g) through (h) No Change.

2220. Options Communications with the Public

(a) No Change.

(b) Approval by [Compliance]a Registered Options and Security Futures

Principal and Recordkeeping

All advertisements, sales literature (except completed worksheets), and educational material issued by a member or member organization pertaining to options shall be approved in advance by [the Compliance Registered Options Principal or designee]a Registered Options and Security Futures Principal designated by the member's written supervisory procedures. Copies thereof, together with the names of the persons who prepared the material, the names of the persons who approved the material and, in the case of sales literature, the source of any recommendations contained therein, shall be retained by the member or member organization and be kept at an easily accessible place for examination by [the Association]NASD for a period of three years.

(c) through (d) No Change.

2860. Options

(a) No Change.

(b) Requirements

(1) through (15) No Change.

(16) Opening of Accounts

(A) through (D) No Change.

(E) Uncovered Short Option Contracts

Each member transacting business with the public in writing uncovered short option contracts shall develop, implement and maintain

specific written procedures governing the conduct of such business which shall include, at least, the following:

(i) through (ii) No Change.

(iii) Designation of [the Senior Registered Options Principal and/or Compliance Registered Options Principal] a specific Registered Options and Security Futures Principal(s) as [the person] responsible for approving customer accounts that do not meet the specific criteria and standards for writing uncovered short option transactions and for maintaining written records of the reasons for every account so approved;

(iv) through (v) No Change.

(17) No Change.

(18) Discretionary Accounts

(A) Authorization and Approval

(i) No Change.

(ii) [The Senior Registered Options Principal] Each firm shall designate specific Registered Options and Security Futures Principals to review discretionary accounts. A Registered Options and Security Futures Principal other than the Registered Options and Security Futures Principal who accepted the account shall review the acceptance of each discretionary account to determine that the Registered Options and Security Futures Principal accepting the account had a reasonable basis for believing that the

customer was able to understand and bear the risk of the strategies or transactions proposed, and shall maintain a record of the basis for such determination. [Each discretionary order shall be approved and initialed on the day entered by the branch office manager or other Registered Options Principal, provided that if the branch office manager is not a Registered Options Principal, such approval shall be confirmed within a reasonable time by a Registered Options Principal. Each] Every discretionary order shall be identified as discretionary on the order at the time of entry. Discretionary accounts shall receive frequent appropriate supervisory review by [the Compliance Registered Options Principal]a Registered Options and Security Futures Principal who is not exercising the discretionary authority. The provisions of this subparagraph (18) shall not apply to discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite number of option contracts in a specified security shall be executed, except that the authority to exercise time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion, absent specific, written contrary indication signed and dated by the customer. This limitation shall not apply to time and price discretion exercised in an institutional account, as defined in Rule 3110(c)(4), pursuant to valid Good-Till-Cancelled

instructions issued on a “not held” basis. Any exercise of time and price discretion must be reflected on the order ticket.

(iii) Any member that does not utilize computerized surveillance tools for the frequent and appropriate review of discretionary activity must establish and implement procedures to require specific Registered Options and Security Futures Principals who have been designated to review discretionary accounts to approve and initial each discretionary order on the day entered.

(B) through (C) No Change.

(19) No Change.

(20) Supervision of Accounts

(A) Duty to Supervise[; Senior Registered Options Principal]

[Every member shall develop and implement a written program providing for the diligent supervision of all of its customer accounts, and all orders in such accounts, to the extent such accounts and orders relate to options contracts, by a general partner (in the case of a partnership) or officer (in the case of a corporation) of the member who is a Registered Options Principal and who has been specifically identified to the Association as the member's Senior Registered Options Principal. A Senior Registered Options Principal, in meeting his responsibilities for supervision of customer accounts and orders, may delegate to qualified employees (including other Registered Options Principals) responsibility and authority for supervision and control of each branch office handling

transactions in option contracts, provided that the Senior Registered Options Principal shall have overall authority and responsibility for establishing appropriate procedures of supervision and control over such employees. Every such member shall also develop and implement specific written procedures concerning the manner of supervision of customer accounts maintaining uncovered short option positions and specifically providing for frequent supervisory review of such accounts.]Each member that conducts a public customer options business shall ensure that its written supervisory system policies and procedures pursuant to Rules 3010, 3012, and 3013 adequately address the member's public customer options business.

[(B) Compliance Registered Options Principal]

[Every member shall designate and specifically identify to the Association a Compliance Registered Options Principal (CROP), who may be the Senior Registered Options Principal, who shall have no sales functions and who shall be responsible to review and to propose appropriate action to secure the member's compliance with securities laws and regulations and Association Rules in respect of its options business. The CROP shall regularly furnish reports directly to the Compliance officer (if the CROP is not himself the Compliance officer) and to other senior management of the member. The requirement that the CROP have no sales functions shall not apply to a member that has received less than \$1,000,000 in gross commissions on options business for either of the

preceding two fiscal years or that currently has ten or fewer registered representatives.]

[(C)](B) Branch Offices

No branch office of a member shall transact an options business unless the principal supervisor of such branch office accepting options transactions has been qualified as either a Registered Options and Security Futures Principal or a Limited Principal—General Securities Sales Supervisor; provided that this requirement shall not apply to branch offices in which no more than three registered representatives are located, so long as the options activities of such branch offices are appropriately supervised by either a Registered Options and Security Futures Principal or a Limited Principal—General Securities Sales Supervisor.

[(D)](C) Headquarters Review of Accounts

Each member shall maintain at the principal supervisory office having jurisdiction over the office servicing customer accounts, or have readily accessible and promptly retrievable, information to permit review of each customer's options account on a timely basis to determine:

- (i) the compatibility of options transactions with investment objectives and with the types of transactions for which the account was approved;
- (ii) the size and frequency of options transactions;
- (iii) commission activity in the account;
- (iv) profit or loss in the account;

(v) undue concentration in any options class or classes, and

(vi) compliance with the provisions of Regulation T of the

Federal Reserve Board.

(21) through (24) No Change.

(c) No Change.

* * * * *

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 III 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

FINRA is proposing to amend its options rules to integrate the responsibility for supervision of a member's public customer options business into its overall supervisory and compliance program. The proposed rule change is substantively similar to recent amendments to the rules of the Chicago Board Options Exchange ("CBOE"), which were approved by the Commission.⁴ As part of these changes, FINRA proposes to eliminate the requirement that a firm must designate a SROP and CROP to be responsible for the overall supervision and compliance programs, respectively, for a member's public

⁴ See Securities Exchange Act Release No. 56971 (December 14, 2007), 72 FR 72804 (December 21, 2007) (Approval Order for File No. SR-CBOE-2007-106).

customer options activities. FINRA believes that the supervisory and compliance function of a member's public customer options activities would be better integrated into the matrix of a firm's overall supervisory and compliance functions rather than separately vested in a SROP and CROP.

FINRA does not believe that eliminating the SROP and CROP requirements would lead to a reduction in supervision, as firms have an obligation to designate an appropriately registered principal(s) to supervise their public customer options activities pursuant to NASD Rule 3010(a)(2).⁵ The proposed rule change would provide firms greater flexibility to incorporate supervision into existing, firm-wide supervisory structures.

The proposed rule change would amend NASD Rule 1022 (Categories of Principal Registration) to delete the reference to the SROP and CROP and clarify that if a person is engaged in the supervision of options and security futures sales practices, including a person designated pursuant to NASD Rule 3010(a)(2), then such person must be registered as a Registered Options and Security Futures Principal ("ROSFP").

The proposed rule change also makes a few technical changes. All references to "Registered Options Principal" would be changed to "Registered Options and Security Futures Principal" to reflect the change in title when rules governing security futures were adopted.⁶ All references to "the Association" would be changed to "NASD" for

⁵ NASD Rule 3010(a)(2) requires that members designate "an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages for which registration as a broker/dealer is required."

⁶ See Securities Exchange Act Release No. 46663 (October 15, 2002), 67 FR 64944 (October 22, 2002) (Approval Order for File No. SR-NASD-2002-040).

ease of reference while the rules continue to be part of the legacy NASD rulebook until such time as the legacy NASD and incorporated NYSE rules are consolidated into the FINRA rule book when all references to “NASD” will be changed to “FINRA.” Finally, all references to “put and call” would be deleted before options and “options” will mean all types of options.

The proposed rule change would amend NASD Rule 2220(b) (Options Communications with the Public) to delete the reference to the CROP and instead require that all advertisements, sales literature (except completed worksheets), and educational material issued by a member or member organization pertaining to options be approved in advance by a ROSFP designated by the member’s written supervisory procedures.

In addition, the proposed rule change would amend NASD Rule 2860 (Options) in several respects. First, paragraph (b)(16)(E)(iii) would be amended to delete the reference to the SROP and CROP and require that a specific ROSFP(s) be designated to be responsible for approving customer accounts that do not meet the specific criteria and standards for writing uncovered short option transactions and for maintaining written records of the reasons for every account so approved. The proposed rule change would allow members the flexibility to assign this responsibility, which currently rests with the SROP and/or CROP, to a specific ROSFP(s).

Second, the proposed rule change would amend paragraph (b)(18) and the treatment of options discretionary accounts. Specifically, under the proposed rule change, each firm would be required to designate specific ROSFPs to review

discretionary accounts.⁷ A ROSFP other than the ROSFP who accepted the account would review the acceptance of each discretionary account to determine that the ROSFP accepting the account had a reasonable basis for believing that the customer was able to understand and bear the risk of the strategies or transactions proposed and must maintain a record of the basis for such determination.

In addition, the proposed rule change would eliminate the requirement in paragraph (b)(18) that discretionary options orders be approved and initialed on the day of entry by the branch office manager or authorized Registered Options Principal (“ROP”) or confirmed within a reasonable time by a ROP if the branch office manager is not a ROP, if a firm uses computerized surveillance tools. Under the proposed rule change, discretionary orders would be required to receive frequent appropriate supervisory review by a ROSFP who is not exercising discretionary authority (instead of a CROP) and be reviewed in accordance with a member’s written supervisory procedures. The proposed rule change would ensure that supervisory responsibilities are assigned to specific ROSFP-qualified individuals, thereby enhancing the quality of supervision.

Firms that do not use computerized surveillance tools for the frequent and appropriate review of discretionary activity would be required to establish and implement procedures to require ROSFPs who have been designated to review discretionary accounts to approve and initial each discretionary order on the day entered. FINRA believes that any member that does not use computerized tools for the frequent and

⁷ Under the existing rule, the SROP must review the acceptance of each discretionary account and the CROP must perform frequency supervisory review of such accounts.

adequate surveillance of options discretionary account activity should continue to be required to perform the daily manual review of discretionary orders.

Paragraph (b)(18) also would be revised to limit the duration of the time and price discretionary authority to the end of the business day on which the customer granted such discretion, absent specific written contrary indication signed and dated by the customer. The limitation would not apply to time and price discretion exercised in an institutional account, as defined in NASD Rule 3110(c)(4), pursuant to valid Good-Till-Cancelled instructions issued on a “not held” basis. The proposed rule change would require any exercise of time and price discretion to be reflected on the order ticket. The proposed rule change mirrors the limitations to discretionary authority provided in NASD Rule 2510(d). FINRA believes that it is appropriate to have consistent treatment of discretionary orders for options as for all other securities.

Third, the proposed rule change would amend paragraph (b)(20) to delete references to a supervision process involving a SROP and CROP, and instead would require each member that conducts a public customer options business to ensure that its written supervisory system policies and procedures pursuant to NASD Rules 3010, 3012, and 3013 adequately address the member’s public customer options business. Although the proposed rule change would eliminate entirely the positions and titles of the SROP and CROP, a member would still be required pursuant to NASD Rule 3010(a)(2) to designate “an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages for which registration as a broker/dealer is required,” which would include designating a ROSFP to supervise a member’s public customer options activities.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 30 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁸ 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 supervisory and compliance function of a member's public customer options activities would be better integrated into the matrix of a firm's overall supervisory and compliance functions rather than separately vested in a SROP and CROP.

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

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

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

Written comments were neither solicited nor received.

⁸ 15 U.S.C. 78o-3(b)(6).

III. 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. Please include File Number SR-FINRA-2007-035 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2007-035. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE,

Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. 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-2007-035 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission Findings

The Commission has carefully reviewed the proposed rule change and finds that it is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.⁹ In particular, the Commission believes that the proposed rule change would help to better integrate the supervisory and compliance functions of a firm's public customer options activities into the firm's overall supervisory and compliance functions, thereby eliminating any uncertainty about where supervisory responsibility lies. Therefore, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,¹⁰ which requires, among other things, that FINRA 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 also finds good cause to approve the proposed rule change prior to the thirtieth day after the date of publication of notice of filing of the amendment in the

⁹ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁰ 15 U.S.C. 78o-3(b)(6).

Federal Register. The proposed rule change is substantially similar to recent CBOE rule amendments concerning options supervision, which were approved by the Commission.¹¹ The Commission believes that approving the proposed rule change will simplify firms' compliance, and is consistent with the public interest and the investor protection goals of the Act. Finally, the Commission finds that it is in the public interest to approve the proposed rule change as soon as possible to expedite its implementation.

Accordingly, the Commission believes good cause exists, consistent with Sections 15A(b)(6) and 19(b) of the Act,¹² to approve the proposed rule change on an accelerated basis.

¹¹ See Securities Exchange Act Release No. 56971 (December 14, 2007), 72 FR 72804 (December 21, 2007) (Approval Order for File No. SR-CBOE-2007-106).

¹² 15 U.S.C. 78o-3(b)(6), and 78s(b).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (File No. SR-FINRA-2007-035), as modified by Amendment No. 1, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁴

Florence E. Harmon
Deputy Secretary

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).