

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58333; File No. SR-FINRA-2008-032)

August 8, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 2350 through 2359 (Regarding Trading in Index Warrants, Currency Index Warrants, and Currency Warrants), FINRA Rule 2360 (Options), and FINRA Rule 2370 (Security Futures) in the Consolidated FINRA Rulebook

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 July 29, 2008, the Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. 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 proposes to adopt NASD Rules 2840 through 2853 regarding Trading in Index Warrants, Currency Index Warrants, and Currency Warrants, 2860 (Options), and 2865 (Security Futures) as FINRA Rules in the consolidated FINRA rulebook (“Consolidated FINRA Rulebook”),³ and to delete the corresponding provisions in Incorporated NYSE Rules 414 (Index

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The current FINRA rulebook consists of two sets of rules: (1) NASD Rules and (2) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together referred to as the “Transitional Rulebook”). The Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). Dual Members also must comply with NASD Rules. For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process).

and Currency Warrants), 424 (Report of Options), and the 700 Series (Option Rules). The proposed rule change would renumber NASD Rules 2840 through 2853 as FINRA Rules 2350 through 2359, NASD Rule 2860 as FINRA Rule 2360, and NASD Rule 2865 as FINRA Rule 2370 in the Consolidated FINRA rulebook. The text of the proposed rule change is available at FINRA, the Commission's Public Reference Room, and www.finra.org.

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

FINRA states that as part of the process of developing the new Consolidated FINRA Rulebook, FINRA is proposing to adopt, with minor changes described below: (1) NASD Rules 2840 through 2853 (regarding Trading in Index Warrants, Currency Index Warrants, and Currency Warrants) as FINRA Rules 2350 through 2359; (2) NASD Rule 2860 (Options) as FINRA Rule 2360; and (3) NASD Rule 2865 (Security Futures) as FINRA Rule 2370.

FINRA states that warrants, options, and security futures rules were adopted to address the specific risks that pertain to these derivative securities, and implement provisions of the

federal securities laws and Commission rules.⁴ These rules include, among other things, provisions requiring specific disclosure documents, additional diligence in approving the opening of accounts, and specific requirements for confirmations, account statements, suitability, recordkeeping, and reporting. The rules also contain provisions imposing limits on the size of an options or warrant position and on the number of options contracts or warrants that can be exercised during a fixed period.

Warrant Rules

FINRA proposes to adopt NASD rules on index warrants, currency index warrants, and currency warrants, NASD Rules 2840 through 2853, as FINRA Rules 2350 through 2359, in substantially the form they exist today. The proposed rule change would reorganize certain requirements, grouping them along similar subject matter lines, by combining the statement of general applicability and definitions into a single rule (FINRA Rule 2351), and creating a single rule addressing position and exercise limits and liquidations (FINRA Rule 2359).

Options Rule

As further described below, FINRA proposes to adopt NASD Rule 2860 as FINRA Rule 2360 with minor modifications to: (1) delete obsolete definitions; (2) change all references to “Registered Options and Security Futures Principal” to “Registered Options Principal;” (3) permit a Limited Principal-General Securities Sales Supervisor to approve the opening of an

⁴ For example, Rule 9b-1(d) under the Act requires a broker-dealer to furnish a customer with a copy of the options disclosure document before accepting an options order from a customer.

options account; (4) modify the confirmation disclosure requirements consistent with recent changes to the equity confirmation disclosure requirements; (5) incorporate NASD Interpretative Materials 2860-1 and 2860-2 into the rule text or as Supplementary Material; and (6) codify as Supplementary Material the provisions in NASD Notice to Members 07-03 (“Notice 07-03”) regarding control relationships.

First, FINRA proposes to delete extraneous definitions from the options rule, many of which became obsolete once the provisions in the options rule pertaining to NASDAQ options were deleted following the separation of NASDAQ from NASD.⁵

Second, FINRA proposes to change the term “Registered Options and Security Futures Principal” to “Registered Options Principal.”⁶ The term Registered Options Principal (“ROP”) was recently changed to Registered Options and Security Futures Principal (“ROSFP”).⁷ However, FINRA believes that the change to ROSFP has generated confusion among the members and believes that reverting to ROP will alleviate these issues. In addition, FINRA believes using the term ROP would promote consistency with the rules of the options exchanges all of which use the term ROP. FINRA notes that the change to the principal title does not affect

⁵ See Securities Exchange Act Release No. 54084 (June 30, 2006), 71 FR 38935 (July 10, 2006) (SR-NASD-2005-087) (approving amendments to the NASD’s Rules following Nasdaq’s operation as a national securities exchange for Nasdaq UTP Plan securities).

⁶ Upon approval of the proposed rule change, FINRA intends to make conforming changes in an immediately effective rule filing to NASD Rule 1022 and IM-1022-1 to change the term “Registered Options and Security Futures Principal” to “Registered Options Principal.” In addition, FINRA plans to make same conforming change to NASD Rule 2220 as part of SR-FINRA-2008-013.

⁷ See Securities Exchange Act Release No 57775 (May 5, 2008), 73 FR 26453 (May 9, 2008) (SR-FINRA-2007-035).

the qualifications needed to supervise options or security futures.⁸

Third, FINRA proposes greater flexibility in the area of account approval in FINRA Rule 2360(b)(16)(B) to allow a Limited Principal-General Securities Sales Supervisor (Series 9/10) - in addition to a ROP (Series 4) - to approve the opening of an options account. FINRA believes that the proposed rule change is consistent with CBOE Rule 9.7 (Opening of Accounts) which permits a Series 9/10 qualified individual serving as a branch manager to approve the opening of an options account.⁹ Under NASD Rule 2860, a Series 9/10 may supervise options trading activity, but may not approve the opening of an options account. FINRA believes that individuals who have passed the Series 9/10 examination are sufficiently qualified to review and approve the opening of an options account.

Fourth, consistent with recent changes in the listed equity markets, FINRA proposes, in adopting FINRA Rule 2360(b)(12), to eliminate the current requirement that an options confirmation specify the exchange(s) upon which the option transaction was executed.¹⁰

Fifth, FINRA proposes to relocate the illustrations of position limit calculations in NASD IM-2860-1 (Position Limits) to Supplementary Material .01 of FINRA Rule 2360 and

⁸ In order to supervise security futures, an individual must successfully pass the Series 4 examination and complete a firm-element continuing education program on security futures. See NASD Notice to Members 02-73 (November 2002) (SEC Approves New Rules and Rule Amendments Concerning Security Futures). Individuals supervising only options are not required to complete a firm-element continuing education program on security futures.

⁹ See also CBOE Rule 9.2 and Interpretation .01 and .02 (specifying the qualification requirements for individuals designated as Registered Options Principals).

¹⁰ See Securities Exchange Act Release No. 57045 (December 27, 2007) 73 FR 529 (January 3, 2008) (SR-FINRA 2007-037). See also FINRA Regulatory Notice 07-65, Amendments to NYSE Rule 409(f): FINRA Amends NYSE Rule 409(f) (Statements of Accounts to Customers) to Eliminate the Requirement to Include the Name of the Securities Market on which a Transaction is Effected (December 2007).

incorporate the provisions from NASD IM-2860-2 (Diligence in Opening Options Accounts) pertaining to opening of options accounts into FINRA Rule 2360(b)(16)(B) and (b)(16)(C).¹¹

Sixth, FINRA proposes to codify as Supplementary Material .02 to FINRA Rule 2360 the provisions in Notice 07-03 pertaining to control relationships, which are explicitly incorporated in NASD Rule 2860(b)(3)(A)(vii)b.2.B.i. Notice 07-03 sets forth the conditions under which FINRA will deem that no control relationship exists between affiliates and between separate and distinct trading units within the same entity. FINRA believes that adding the relevant provisions of Notice 07-03 as Supplementary Material will make the rule more self-contained and easier to follow.

Security Futures Rule

FINRA proposes to adopt NASD Rule 2865 as FINRA Rule 2370 with minor changes to preserve the general parallel treatment of options and security futures.¹² In particular, FINRA proposes to update the provisions regarding discretionary accounts to conform to recent rule

¹¹ Provisions regarding verification of a customer's background and financial information have transferred unchanged to FINRA Rule 2360(b)(16)(C). Members are reminded that they can only recommend transactions for the purchase or sale (writing) of option contracts if they have reasonable grounds for believing, at the time of making the recommendation based on any information known by the member or associated person, that the recommended transaction is not unsuitable for the customer. See NASD Rule 2860(b)(19).

¹² One of the underpinnings of the Commodity Futures Modernization Act of 2000 is that the regulation of security futures should be comparable to the regulation of options. In approving NASD Rule 2865 (Securities Futures), the Commission stated: "The system of joint regulation of security futures established by the Commodity Futures Modernization Act is intended to prevent competitive advantages from arising solely out of differences between securities regulation and futures regulation.... The Commission believes that the rule change should promote just and equitable principles of trade by preventing regulatory disparities from occurring between options and security futures." Securities Exchange Act Release No. 46663 (October 15, 2002), 67 FR 64944 (October 22, 2002) (SR-NASD-2002-40) (approving NASD Rules 1022, 1032, 2210, 3010, 3370, IM-1022-1, and IM-1022-2, 2865, and IM-2210-7).

amendments made to the options rule.¹³ Under the proposed rule change, each firm must designate specific principals qualified to supervise security futures activities to review discretionary accounts.¹⁴ A principal other than the principal who accepted the account would review the acceptance of each discretionary account to determine that the principal accepting the account had a reasonable basis for believing that the customer was able to understand and bear the risks of the strategies or transactions proposed and must maintain a record of the basis for such determination.

To mirror recent changes to the options rule, the proposed rule change would eliminate the requirement that discretionary orders be approved on the day of entry by a principal qualified to supervise security futures activities if a firm uses computerized surveillance tools. Discretionary orders for firms using computerized surveillance tools instead may be reviewed in accordance with the member firm's written supervisory procedures. Firms that do not use computerized surveillance tools must, as they do today, establish and implement procedures requiring principals qualified to supervise security futures activities who have been designated to review discretionary accounts to approve and initial each discretionary order on the day entered.¹⁵

Finally, FINRA proposes 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. This limitation would not

¹³ See Securities Exchange Act Release No. 57775 (May 5, 2008), 73 FR 26453 (May 9, 2008) (SR-FINRA-2007-035).

¹⁴ As provided in NASD Rule 1022(f)(5), any ROP that supervises security futures products must complete a firm-element continuing education program that addresses security futures and a principal's responsibilities for supervising such products.

¹⁵ See supra note 13.

apply to discretion exercised in an institutional account, as defined in NASD Rule 3110(c)(4), pursuant to Good-Till-Canceled instructions issued on a “not held” basis. The proposed rule change would require that any exercise of time and price discretion be reflected on the order ticket. These changes mirror the limitations to discretionary authority provided in NASD Rule 2510(d) and the options rule.

Deleted Rules

FINRA proposes to delete the following Incorporated NYSE Rules as the substance of such rules is addressed in the proposed FINRA rules:¹⁶ Incorporated NYSE Rules 414 (Index and Currency Warrants); 424 (Reports of Options); 700 (Applicability, Definitions and References); 704 (Position Limits); 705 (Exercise Limits); 707 (Liquidation of Positions); 709 (Other Restrictions on Exchange Option Transactions and Exercises); 720 (Registration of Options Principals); 721 (Opening of Accounts); 722 (Supervision of Accounts); 723 (Suitability); 724 (Discretionary Accounts); 725 (Confirmations); 726 (Delivery of Options Disclosure Document and Prospectus); 727 (Transactions with Issuers); 728 (Restricted Stock); 730 (Statement of Accounts); 732 (Customer Complaints); 780 (Exercise of Option Contracts); 781 (Allocation of Exercise Assignment Notices); and 791 (Communications to Customers).

FINRA would announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval.

¹⁶ FINRA states that, moreover, in several instances, the Incorporated NYSE Rules are no longer applicable by their own terms as the NYSE no longer trades options.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁷ 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. The proposed rule change makes minor changes to rules that have proven effective in meeting the statutory mandates. Moreover, as described in the proposed rule change, certain amended provisions seek to conform FINRA rules to existing provisions of other self-regulatory organizations or are consistent with other rule changes. FINRA believes that the proposed rules promote the public interest and protect investors who invest in and trade these derivative products.

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.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. by order approve such proposed rule change; or

¹⁷ 15 U.S.C. 78q-3(b)(6).

- B. institute proceedings to determine whether the proposed rule change should be disapproved.

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. Please include File Number SR-FINRA-2008-032 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2008-032. 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 a.m. and 3:00

p.m. Copies of the 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-2008-032 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.¹⁸

Florence E. Harmon
Acting Secretary

¹⁸ 17 CFR 200.30-3(a)(12).