

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-58738; File No. SR-FINRA-2008-013)

October 6, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of Proposed Rule Change as Modified by Amendment No. 1 Relating To Amending NASD Rule 2220 (Options Communications with the Public)

I. Introduction

On April 7, 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 (“SEC” or “Commission”) a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> Notice of the proposal was published for comment in the Federal Register on May 2, 2008.<sup>3</sup> The Commission received one comment letter in response to the proposed rule change.<sup>4</sup> On September 16, 2008, FINRA filed Amendment No. 1 to the proposed rule change (“Amendment No. 1”).<sup>5</sup> This order provides notice of the

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

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

<sup>3</sup> See Securities Exchange Act Release No. 57720 (April 25, 2008), 73 FR 24332 (May 2, 2008) (SR-FINRA-2008-013) (notice).

<sup>4</sup> See letter from Melissa MacGregor, Vice President and Assistant General Counsel, Securities Industry and Financial Markets Association (“SIFMA”), dated May 22, 2008.

<sup>5</sup> Amendment No. 1 responds to the issues raised in the comment letter and proposes to amend the rule text to reflect certain rule changes that have already taken effect, and to change the term “Registered Options and Security Futures Principal” to “Registered Options Principal,” as discussed in further detail in the section titled “Amended Proposal” below.

proposed rule change, as modified by Amendment No. 1, and approves the proposed rule change, as amended, on an accelerated basis.

## II. Description

### Background

FINRA and other SROs have sought to modernize their rules concerning options communications with the public. One of the goals of this rule modernization is to make the rules on options communications consistent with the general rules on communications with the public. To this end, FINRA proposes to: (1) use, to the extent appropriate, the same terminology and definitions as in its general communications rules; (2) make the requirements for principal review of correspondence concerning options the same as for correspondence generally; and (3) update the standards on the content of communications that precede the delivery of the options disclosure document ("ODD"). A discussion of the specific changes is provided below.

### NASD Rule 2220(a) Definitions

The proposed rule change would amend the definitions in NASD Rule 2220(a) to adopt (and classify collectively as "options communications") definitions of "advertisement," "sales literature," "independently prepared reprint," "correspondence," "institutional sales material," and "public appearance"<sup>6</sup> that are consistent with those terms as they are defined in FINRA's general advertising rules – NASD Rule 2210 (Communications with the Public) and NASD Rule 2211 (Institutional Sales Material and

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<sup>6</sup> Options communications that qualify as public appearances (e.g., seminars, radio, forums) may also qualify as other forms of options communications (e.g., advertisements, sales literature). For example, the writing of a print media article would generally qualify as both an advertisement and a public appearance. Seminar scripts, handouts, slides, or other visual presentations would also generally be deemed to be sales literature.

Correspondence).<sup>7</sup> With respect to the definition of "sales literature," the proposed rule change also would make clear that worksheet templates, which are commonly used in the marketing of options, are included within the definition of sales literature.<sup>8</sup> The proposed rule change also would adopt the definition of "existing retail customer" set forth in NASD Rule 2211.<sup>9</sup>

In addition, the proposed rule change would eliminate NASD Rule 2220's current definition of "educational material," which is a term unique to options communications. Communications that would previously have been considered "educational material" would now be classified as either "advertisements" or "sales literature." This approach also would allow FINRA members to continue to create educational material concerning options, while at the same time providing members with greater flexibility in designing such materials.

The proposed rule change would also adopt the definition of "options" as defined in NASD Rule 2860(a) (Options), FINRA's general rule governing members' conduct when engaging in options activity. NASD Rule 2220 currently does not have a definition for the term "options." Adopting NASD Rule 2860's definition of that term would not only clarify the meaning of "options" as it is used in NASD Rule 2220, it would also promote consistency between the two rules.

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<sup>7</sup> See NASD Rule 2210(a)(1), (2), (5) & (6)(A); NASD Rule 2211(a)(1), and (2).

<sup>8</sup> The definition of "sales literature" in NASD Rule 2210(a)(2) includes many examples but does not include worksheets. In view of that fact that other SROs' definitions of "sales literature" include "worksheets," FINRA has expressly included "worksheet templates" in the definition of sales literature in proposed Rule 2220(a)(1)(B) to ensure consistency and avoid any ambiguity.

<sup>9</sup> See Rule NASD 2211(a)(4).

Additionally, the proposed rule change would define the term “standardized option” for purposes of NASD Rule 2220 to mean any option contract issued, or subject to issuance, by The Options Clearing Corporation (“OCC”), that has standardized terms for the strike price, expiration date, and amount of the underlying security, and is traded on a national securities exchange registered pursuant to Section 6(a) of the Act. FINRA proposed this definition to help members understand the meaning of this term as it is used in proposed NASD Rule 2220(d)(1), which details the standards applicable to communications regarding standardized options exempted under SEC Rule 238 under the Securities Act of 1933 (“Securities Act”) that are used prior to delivery of the ODD, and to communications regarding options not exempted under SEC Rule 238 that are used prior to delivery of a prospectus that meets the requirements of Section 10(a) of the Securities Act.

Finally, the proposed rule change would define “options disclosure document” as having the same meaning as the definition of the term “disclosure document” defined in NASD Rule 2860.<sup>10</sup> FINRA believes that having a specific definition of “options disclosure document” would assist members in correctly understanding and applying the proposed rule changes.

NASD Rule 2220(b) Approval by Registered Options Principal<sup>11</sup> and Recordkeeping

The proposed rule change would remove the outdated term “educational material” in the requirement in NASD Rule 2220(b) to have an options principal approve prior to

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<sup>10</sup> See NASD Rule 2860(b)(2)(T).

<sup>11</sup> As discussed in the section titled “Amended Proposal” below, FINRA is proposing to change the term “Registered Options and Security Futures Principal” to “Registered Options Principal.”

use certain options communications and would add “independently prepared reprints” to the types of options communications that require pre-use approval by an options principal. The proposed rule change would also exclude “completed worksheets” from those materials requiring approval of an options principal. Because the definition of “sales literature” includes “worksheet templates” this exclusion would clarify that only the templates, and not each subsequent worksheet with data, is required to be approved by an options principal.

In addition, the proposed rule change would include new requirements for principal review of correspondence in NASD Rule 2220(b) that are consistent with recently amended correspondence principal approval requirements in NASD Rule 2211.<sup>12</sup> As noted previously, because Rule NASD 2220 currently does not have a definition of correspondence, the proposed rule change would incorporate NASD Rule 2211’s definition of “correspondence,” which classifies correspondence as any written letter or electronic mail message distributed by a member to one or more of its existing retail customer and to fewer than 25 prospective retail customers within any 30 calendar-day period.<sup>13</sup> Pursuant to the proposed rule change, correspondence would not need to be approved by a Registered Options Principal prior to use, unless such correspondence is distributed to 25 or more existing retail customers within any 30 calendar-day period and makes any financial or investment recommendation or otherwise promotes a product or service of the member. Also consistent with NASD Rule 2210, any written letters,

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<sup>12</sup> See Securities Exchange Act Release No. 54217 (July 26, 2006), 71 F.R. 43831 (August 2, 2006) (SR-NASD-2006-011) (approval order).

<sup>13</sup> Previously, such material would have been examined to determine whether it should be considered an advertisement, sales literature, or educational material.

emails, or instant messages to 25 or more prospective retail customers within any 30 calendar-day period would be deemed sales literature, which would have to be approved prior to use by a Registered Options Principal.<sup>14</sup> Finally, as with NASD Rule 2210, the proposed rule change would make clear that all correspondence concerning options is subject to NASD Rule 3010(d)'s supervision and review requirements.

The proposed rule change would also include new requirements for principal review of institutional sales material in NASD Rule 2220(b)(3) that are consistent with the principal review requirements for general institutional sales material in NASD Rule 2211. As noted previously, because NASD Rule 2220 does not have a definition of institutional sales material, the proposed rule change would incorporate NASD Rule 2211's definition of "institutional sales material," which classifies institutional sales material as any communication that is distributed or made available only to institutional customers.<sup>15</sup> Pursuant to the proposed rule change, each member would be required to establish written procedures that are appropriate for its business size, structure, and customers for the review by a Registered Options Principal of institutional sales material used by the member and its registered representatives as described in NASD Rule 2211(b)(1)(B).<sup>16</sup>

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<sup>14</sup> See NASD Notice to Members 06-45 (August 2006). FINRA anticipates that other SROs will adopt similar standards to FINRA.

<sup>15</sup> Previously, such material would have been examined to determine whether it should be considered an advertisement, sales literature or educational material.

<sup>16</sup> NASD Rule 2211(b)(1)(B) requires such procedures to be in writing and be designed to reasonably supervise each registered representative. Where such procedures do not require review of all institutional sales material prior to use or distribution, they must include provision for the education and training of associated persons as to the firm's procedures governing institutional sales material, documentation of such education and training, and surveillance and

The proposed rule change also would require that a member retain copies of the options communications in accordance with Rule 17a-4 under the Act. Additionally, a member would be required to retain the names of the persons who prepared the communications and the source of any recommendations contained in the communications and keep them in the form and for the time period required for options communications required in Rule 17a-4 under the Act.

NASD Rule 2220(c) FINRA Approval Requirements and Review Procedures

Currently, NASD Rule 2220(c)(1) requires members to submit all options advertisements and educational material to FINRA's Advertising Regulation Department (the "Department") for approval at least ten days prior to use (or such shorter period as FINRA may allow) but does not require members to submit sales literature. The effect has been that widely disseminated communications (i.e., advertisements and educational material) used prior to delivery of the ODD are filed for approval while more targeted communications (i.e., sales literature, as previously defined) that must be preceded or accompanied by the ODD are exempted from filing. FINRA intends to follow a similar approach in the proposed rule change. Communications concerning standardized options that are likely to be widely disseminated such as advertisements, sales literature (as newly defined), and independently prepared reprints would be subject to filing under the proposed rule change. In contrast, more targeted communications – generally correspondence – that will be used once the applicable ODD or prospectus has been delivered would continue to be exempt from the filing requirements. In addition, as

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follow-up to ensure that such procedures are implemented and adhered to. Evidence that these supervisory procedures have been implemented and carried out must be maintained and made available to FINRA upon request.

discussed below, communications used prior to the delivery of the ODD or prospectus would be subject to the more stringent content standards in subparagraph (d)(1). The proposed rule change would also modify existing rule text to clarify that the filing must occur at least ten calendar days prior to use (or such shorter period as the Department may allow in particular instances).

The proposed rule change would delete NASD Rule 2220(c)(5), which prohibits the distribution of any written material, except as described in subparagraphs (d)(2)(B) and (C), respecting options to any person who had not previously or contemporaneously received one or more current options disclosure documents. This requirement would be subsumed into proposed NASD Rule 2220(d)(1) which would establish the standards for communications that may be used prior to delivery of the options disclosure document or prospectus.

#### NASD Rule 2220(d) Standards Applicable to Communications

The proposed rule change would make several amendments to the standards applicable to options communications contained in NASD Rule 2220(d). First, new NASD Rule 2220(d)(1) would clarify and update the standards limiting the content of communications regarding standardized options, as that term is defined and discussed earlier in the proposed rule change. Specifically, proposed new NASD Rule 2220(d)(1)(A) would provide that communications regarding standardized options exempted under SEC Rule 238 under the Securities Act that are used prior to delivery of the ODD must be limited to general descriptions of the options being discussed. This could include a brief description of options, including a statement that identifies registered clearing agencies for options and a brief description of the general attributes



and method of operation of the exchanges on which such options are traded, including a discussion of how an option is priced. In addition, such options communications would be required to include contact information for obtaining a copy of the ODD, but could not contain recommendations or past or projected performance figures, including annualized rates of return, or names of specific securities. These options communications could also include any statement required by any state law and administrative authority as well as any advertising designs and devices, provided such material is not misleading.

Second, proposed new NASD Rule 2220(d)(1)(B) would provide that options communications regarding options not exempted under SEC Rule 238 that are used prior to delivery of a prospectus that meets the requirements of the Securities Act Section 10(a) must conform to SEC Rule 134 or 134a under the Securities Act, as applicable.

Third, the proposed rule change would broaden NASD Rule 2220(d)(2), which prohibits hedge clauses or disclaimers that are not legible, attempt to disclaim responsibility, or are otherwise inconsistent, by deleting references to disclaimers and the outdated term "hedge clauses" and instead generally prohibiting the use of illegible, misleading, or inconsistent cautionary statements or caveats.

Fourth, the proposed rule change would require all options communications, with the exception of institutional sales material, to include a statement that supporting documentation for any claims (including any claims made on behalf of options programs or the options expertise of sales persons), comparison, recommendations, statistics, or other technical data, will be supplied upon request. Currently, NASD Rule 2220(d)(2)(D) only requires sales literature to include this statement.

Fifth, the proposed rule change would except institutional sales materials from

being required to include the existing required disclosure that options are not suitable for all investors. This disclaimer appears unnecessary in institutional sales material because, for purposes of this provision, institutions are viewed to be sufficiently sophisticated to be aware that options are not suitable for all investors.

Sixth, proposed changes to NASD Rules 2220(d)(3) and (d)(4) would permit projected and historical performance figures in any options communications. Currently, only communications defined as sales literature may contain this information.<sup>17</sup> The proposed rule change also would require all such communications regarding standardized options to be preceded or accompanied by the ODD. In addition, all relevant costs would be required to be disclosed and reflected in the projections.

Seventh, the proposed rule change would amend Rule NASD 2220(d)(6) to provide that any violation by a member or associated person of any rule or requirement of the SEC or any rule of the Securities Investor Protection Corporation applicable to member communications regarding options will be deemed a violation of NASD Rule 2220. This approach is consistent with NASD Rule 2210.<sup>18</sup>

#### General Technical Amendments to NASD Rule 2220

The proposed rule change also would delete and update outdated rule language identified by the Options Self Regulatory Council and the subcommittee assigned to update the SROs' options communications rules. In particular, the proposed rule change would replace references throughout NASD Rule 2220 to "material" with the term "communications."

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<sup>17</sup> See Rule NASD 2220(d)(2)(D)(ii).

<sup>18</sup> See Rule 2210(e).

FINRA believes that the proposed rule change will better address the needs for regulating current options communications practices and promote consistency across SROs. After these proposed changes are filed with the SEC, FINRA and other SROs will begin work on updating the Guidelines for Options Communications.<sup>19</sup>

Amendment No. 1

In addition, FINRA is proposing several technical changes to reflect recently approved changes in the current rule text and to change the term “Registered Options and Security Futures Principal” to “Registered Options Principal.” The term Registered Options Principal (“ROP”) was recently changed to Registered Options and Security Futures Principal (“ROSP”).<sup>20</sup> 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 that using the term ROP would promote consistency with the rules of options exchanges, all of which use the term ROP.<sup>21</sup>

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<sup>19</sup> The Guidelines for Options Communications is an industry-wide publication prepared by FINRA and the options exchanges. The Guidelines explain the SROs' options communications rules and interpretations, address frequently asked questions and common problems, and provide a framework for informative and effective communications with the public.

<sup>20</sup> See Securities Exchange Act Release No. 57775 (May 5, 2008), 73 FR 26453 (May 9, 2008) (SR-FINRA-2007-035).

<sup>21</sup> See Securities Exchange Act Release No. 58333 (August 8, 2008); 73 FR 47991 (August 15, 2008) (SR-FINRA-2008-032) (proposing the same term change for related options rules).

### III. Comment Letter

The Commission received one comment letter from SIFMA in response to the proposed rule change.<sup>22</sup> FINRA responded to this comment letter in Amendment No. 1.

In general, SIFMA supported the proposed rule change noting, among other things, that it was better aligned with the other FINRA communications rules.<sup>23</sup> Most of SIFMA's substantive comments addressed the requirements in NASD Rule 2860 (Options) to deliver the Options Disclosure Document ("ODD") and recent supplements thereto.<sup>24</sup> FINRA stated that these comments, which include a request to consider a "notice-equals-delivery" standard for ODD supplements, are outside the scope of the proposed rule change, which is limited to NASD Rule 2220, and therefore, are not addressed in this filing.

With respect to the proposed rule change, SIFMA opposed limitations on the types of options communications that can be made prior to delivery of the ODD because all customers must receive the ODD at or prior to the time an options account is opened.<sup>25</sup> SIFMA stated that the requirement to distribute the ODD prior to certain types of options communications is unnecessary and duplicative, and limits firms to sending prospective customers generalized materials that do not provide the necessary information for analyzing potential options investments.<sup>26</sup>

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<sup>22</sup> See supra, note 4.

<sup>23</sup> See SIFMA letter.

<sup>24</sup> Id.

<sup>25</sup> Id.

<sup>26</sup> Id.

FINRA stated in its response, that this issue was considered by FINRA and other SROs governing options prior to filing the proposed rule change. FINRA indicated that the *subsequent* delivery of the ODD would not aid an investor in understanding or evaluating options communications, and therefore decided to maintain the existing limitations on the types of options communications that may precede delivery of the ODD. FINRA noted that delivery of the ODD can be effected by a hyperlink to the ODD, so the requirement that the ODD either precede or accompany these options communications poses virtually no burden with respect to electronic communications that would be considered sales literature or advertisements.<sup>27</sup>

SIFMA also opposed the requirement to deliver the full text of the ODD to prospective customers during a seminar or a similar in-person meeting.<sup>28</sup> SIFMA suggested that instead of providing the full ODD, firms should provide information on

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<sup>27</sup> The SEC's 1995 and 1996 releases on the use of electronic media for delivery of information provide that a hyperlink contained in sales literature is sufficient for electronic delivery of a prospectus (or other required information) as it is analogous to an investor's selecting an envelope containing a paper prospectus and sales literature from a display at an office of a broker-dealer. See Securities Act Release No. 7233 (October 6, 1995); 60 FR 53458 (October 13, 1995); see also Securities Act Release No. 7288 (May 9, 1996); 61 FR 24644, n.16 (May 15, 1996) (recognizing that the ability to jump via hyperlink from the sales literature to view and download the prospectus would be sufficient to comply with Securities Act Section 5(b) requiring sales literature to be preceded or accompanied by a final prospectus).

Delivery of the ODD for purposes of NASD Rule 2860(b)(11) also can be satisfied by a hyperlink to the ODD, subject to the limitations set forth in the SEC's 1995 and 1996 releases. See Notice to Members 98-03 (January 1998) (members may electronically transmit documents that they are required or permitted to furnish to customers under NASD Rules, including the delivery of the ODD required by NASD Rule 2860(b)(11)); see also Securities Exchange Act Release No. 39356 (November 25, 1997); 62 FR 64421 (December 5, 1997) (order approving Notice to Members 98-03).

<sup>28</sup> See SIFMA letter.

how to access the ODD.<sup>29</sup> FINRA responded by stating that the requirement to deliver the ODD to prospective customers during a seminar or in-person meeting should be maintained as it also poses virtually no burden and makes the disclosures to a prospective customer as accessible as other forms of options communications.

#### IV. Discussion and Findings

After careful review of the proposed rule change, the comment letter and FINRA's response to the comment letter, the Commission finds that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to a national securities association.<sup>30</sup> In particular, the Commission believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>31</sup> 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 believes that the proposed rule change would provide the investing public with options communications rules that are designed to provide appropriate safeguards and greater clarity by promoting harmonization between FINRA's and other SROs' options communications rules.

The Commission also finds good cause to approve the proposed rule change, as modified by Amendment No. 1, prior to the thirtieth day after the date of publication of notice of filing of the amendment in the Federal Register. The proposed rule change was

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<sup>29</sup> Id.

<sup>30</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. See 15 U.S.C. 78c(f).

<sup>31</sup> 15 U.S.C. 78o-3(b)(6).

published in the Federal Register on May 2, 2008.<sup>32</sup> FINRA submitted Amendment No. 1 in response to comments received on the proposed rule change and to reflect recently approved changes to the rule text. Amendment No. 1 does not materially modify the scope of the proposed rule change as published in the Federal Register. The Commission believes that approving Amendment No. 1 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 Section 19(b)(2) of the Act<sup>33</sup> to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

#### VI. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2008-013 on the subject line.

##### Paper Comments:

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<sup>32</sup> See *supra* note 3.

<sup>33</sup> 15 U.S.C. 78s(b)(2).

- 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-2008-013. 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 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-2008-013 and should be submitted on or before [insert date 21 days from publication in the Federal Register].



V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>34</sup> that the proposed rule change (SR-FINRA-2008-013), 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.<sup>35</sup>

Florence E. Harmon  
Acting Secretary

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<sup>34</sup> 15 U.S.C. 78s(b)(2).

<sup>35</sup> 17 CFR 200.30-3(a)(12).