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debt research analyst account to trade in a manner inconsistent with such research analyst's most recently published recommendation;

(K) prohibit explicit or implicit promises of favorable debt research, a particular debt research rating or recommendation or specific debt research content as inducement for the receipt of business or compensation;

(L) restrict or limit activities by debt research analysts that can reasonably be expected to compromise their objectivity, including prohibiting:

(i) participation in pitches and other solicitations of investment banking services transactions; and

(ii) participation in road shows and other marketing on behalf of an issuer related to an investment banking services transaction;

(M) prohibit investment banking department personnel from directly or indirectly:

(i) directing a debt research analyst to engage in sales or marketing efforts related to an investment banking services transaction; and

(ii) directing a debt research analyst to engage in any communication with a current or prospective customer about an investment banking services transaction;

(N) prohibit prepublication review of a debt research report by a subject company for purposes other than verification of facts.

### (c) Content and Disclosure in Debt Research Reports

(1) A member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that:

(A) purported facts in its debt research reports are based on reliable information; and

(B) any recommendation or rating has a reasonable basis and is accompanied by a clear explanation of any valuation method used and a fair presentation of the risks that may impede achievement of the recommendation or rating.

(2) A member that employs a rating system must clearly define in each debt research report the meaning of each rating in the system, including the time horizon and any benchmarks on which a rating is based. The definition of each rating must be consistent with its plain meaning.

(A) Irrespective of the rating system a member employs, a member must include in each debt research report limited to the analysis of an issuer of a debt security that

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includes a rating of the subject company the percentage of all subject companies rated by the member to which the member would assign a "buy," "hold" or "sell" rating.

(B) A member must disclose in each debt research report the percentage of subject companies within each of the "buy," "hold" and "sell" categories for which the member has provided investment banking services within the previous 12 months.

(C) The information required in paragraphs (c)(2)(A) and (B) of this Rule must be current as of the end of the most recent calendar quarter or the second most recent calendar quarter if the publication date of the debt research report is less than 15 calendar days after the most recent calendar quarter.

(3) If a debt research report limited to the analysis of an issuer of a debt security contains a rating for the subject company, and the member has assigned a rating to such subject company for at least one year, the debt research report must show each date on which a member has assigned a rating and the rating assigned on such date. The member must include this information for the period that the member has assigned any rating or for a three-year period, whichever is shorter.

(4) A member must disclose in any debt research report at the time of publication or distribution of the report:

(A) if the debt research analyst or a member of the debt research analyst's household has a financial interest in the debt or equity securities of the subject company (including, without limitation, any option, right, warrant, future, long or short position), and the nature of such interest;

(B) if the debt research analyst has received compensation based upon (among other factors) the member's investment banking, sales and trading or principal trading revenues;

(C) if the member or any of its affiliates:

(i) managed or co-managed a public offering of securities for the subject company in the past 12 months;

(ii) received compensation for investment banking services from the subject company in the past 12 months; or

(iii) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;

(D) if, as of the end of the month immediately preceding the date of publication or distribution of a debt research report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month) the

member or its affiliates have received from the subject company any compensation for products or services other than investment banking services in the previous 12 months;

(E) if the subject company is, or over the 12-month period preceding the date of publication or distribution of the debt research report has been, a client of the member, and if so, the types of services provided to the issuer. Such services, if applicable, shall be identified as either investment banking services, non-investment banking securities-related services or non-securities services;

(F) if the member trades or may trade as principal in the debt securities (or in related derivatives) that are the subject of the debt research report;

(G) if the debt research analyst received any compensation from the subject company in the previous 12 months; and

(H) any other material conflict of interest of the debt research analyst or member that the debt research analyst or an associated person of the member with the ability to influence the content of a debt research report knows or has reason to know at the time of the publication or distribution of a debt research report.

(5) A member or debt research analyst will not be required to make a disclosure required by paragraph (c)(4) of this Rule to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions.

(6) Except as provided in subparagraph (7), the disclosures required by this paragraph (c) must be presented on the front page of debt research reports or the front page must refer to the page on which the disclosures are found. Electronic debt research reports may provide a hyperlink directly to the required disclosures. All disclosures and references to disclosures required by this Rule must be clear, comprehensive and prominent.

(7) A member that distributes a debt research report covering six or more subject companies (a "compendium report") may direct the reader in a clear manner as to where the reader may obtain applicable current disclosures required by this paragraph (c). Electronic compendium reports must include a hyperlink to the required disclosures. Paper-based compendium reports must provide either a toll-free number to call or a postal address to request the required disclosures and also may include a web address of the member where the disclosures can be found.

#### (d) Disclosure in Public Appearances

(1) A debt research analyst must disclose in public appearances:

(A) if the debt research analyst or a member of the debt research analyst's household has a financial interest in the debt or equity securities of the subject company (including,

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without limitation, whether it consists of any option, right, warrant, future, long or short position), and the nature of such interest;

(B) if, to the extent the debt research analyst knows or has reason to know, the member or any affiliate received any compensation from the subject company in the previous 12 months;

(C) if the debt research analyst received any compensation from the subject company in the previous 12 months;

(D) if, to the extent the debt research analyst knows or has reason to know, the subject company currently is, or during the 12-month period preceding the date of publication or distribution of the debt research report, was, a client of the member. In such cases, the debt research analyst also must disclose the types of services provided to the subject company, if known by the debt research analyst; or

(E) any other material conflict of interest of the debt research analyst or member that the debt research analyst knows or has reason to know at the time of the public appearance.

(2) A member or debt research analyst will not be required to make a disclosure required by this paragraph (d) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions.

(3) Members must maintain records of public appearances by debt research analysts sufficient to demonstrate compliance by those debt research analysts with the applicable disclosure requirements in this paragraph (d). Such records must be maintained for at least three years from the date of the public appearance.

#### (e) Disclosure Required by Other Provisions

In addition to the disclosures required by paragraphs (c) and (d) of this Rule, members and debt research analysts must comply with all applicable disclosure provisions of Rule 2210 and the federal securities laws.

#### (f) Distribution of Member Research Reports

A member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that a debt research report is not distributed selectively to trading personnel or a particular customer or class of customers in advance of other customers that the member has previously determined are entitled to receive the debt research report.

#### (g) Distribution of Third-Party Debt Research Reports

(1) A member may not distribute third-party debt research if it knows or has reason to know such research is not objective or reliable.

(2) A member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that any third-party debt research report it distributes contains no untrue statement of material fact and is otherwise not false or misleading. For the purposes of this paragraph (g)(2) only, a member's obligation to review a third-party debt research report extends to any untrue statement of material fact or any false or misleading information that:

(A) should be known from reading the debt research report; or

(B) is known based on information otherwise possessed by the member.

(3) A member must accompany any third-party debt research report it distributes with, or provide a web address that directs a recipient to, disclosure of any material conflict of interest that can reasonably be expected to have influenced the choice of a third-party debt research report provider or the subject company of a third-party debt research report, including the disclosures required by paragraphs (c)(4)(C), (c)(4)(F) and (c)(4)(H) of this Rule.

(4) A member shall not be required to review a third-party debt research report to determine compliance with paragraph (g)(2) of this Rule if such debt research report is an independent third-party debt research report.

(5) A member shall not be considered to have distributed a third-party debt research report for the purposes of paragraph (g)(3) where the research is an independent third-party debt research report and made available by a member (a) upon request; (b) through a member-maintained website; or (c) to a customer in connection with a solicited order in which the registered representative has informed the customer, during the solicitation, of the availability of independent debt research on the solicited debt security and the customer requests such independent debt research.

(6) A member must ensure that a third-party debt research report is clearly labeled as such and that there is no confusion on the part of the recipient as to the person or entity that prepared the debt research report.

(h) Exemption for Members with Limited Investment Banking Activity

The provisions of paragraphs (b)(2)(A)(i), (b)(2)(B), (b)(2)(C) (with respect to investment banking), (b)(2)(D)(i), (b)(2)(E) (with respect to investment banking), (b)(2)(G) and (b)(2)(H)(i) and (iii) of this Rule shall not apply to members that over the previous three years, on average per year, have participated in 10 or fewer investment banking services transactions as manager or co-manager and generated \$5 million or less in gross investment banking revenues from those transactions; provided, however, that with respect to paragraph (b)(2)(H)(i) and (iii) of this Rule, such members must establish

information barriers or other institutional safeguards reasonably designed to ensure debt research analysts are insulated from pressure by persons engaged in investment banking services activities or other persons, including persons engaged in principal trading or sales and trading activities, who might be biased in their judgment or supervision. For the purposes of this paragraph (h), the term "investment banking services transactions" includes the underwriting of both corporate debt and equity securities but not municipal securities. Members that qualify for this exemption must maintain records sufficient to establish eligibility for the exemption and also maintain for at least three years any communication that, but for this exemption, would be subject to paragraphs (b)(2)(A)(i), (b)(2)(B), (b)(2)(C), (b)(2)(D)(i), (b)(2)(E), (b)(2)(G) and (b)(2)(H)(i) and (iii) of this Rule.

(i) Exemption for Limited Principal Trading Activity

The provisions of paragraphs (b)(2)(A)(ii) and (iii), (b)(2)(B), (b)(2)(C) (with respect to sales and trading and principal trading), (b)(2)(D)(ii) and (iii), (b)(2)(E) (with respect to principal trading), (b)(2)(G) and (b)(2)(H)(ii) and (iii) of this Rule shall not apply to members where (1) in absolute value on an annual basis, the member's trading gains or losses on principal trades in debt securities are \$15 million or less over the previous three years, on average per year; and (2) the member employs fewer than 10 debt traders; provided, however, that with respect to paragraph (b)(2)(H)(ii) and (iii) of this Rule, such members must establish information barriers or other institutional safeguards reasonably designed to ensure debt research analysts are insulated from pressure by persons engaged in principal trading or sales and trading activities or other persons who might be biased in their judgment or supervision. Members that qualify for this exemption must maintain records sufficient to establish eligibility for the exemption and also maintain for at least three years any communication that, but for this exemption, would be subject to paragraphs (b)(2)(A)(ii) and (iii), (b)(2)(B), (b)(2)(C), (b)(2)(D)(ii) and (iii), (b)(2)(E), (b)(2)(G) and (b)(2)(H)(ii) and (iii) of this Rule.

(j) Exemption for Debt Research Reports Provided to Institutional Investors

(1) Except as provided in paragraphs (j)(2) and (j)(3) of this Rule, the provisions of this Rule shall not apply to the distribution of a debt research report to:

(A) A qualified institutional buyer where, pursuant to Rule 2111(b):

(i) the member or associated person has a reasonable basis to believe that the qualified institutional buyer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a debt security or debt securities; and

(ii) such qualified institutional buyer has affirmatively indicated that it is exercising independent judgment in evaluating the member's recommendations pursuant to Rule 2111 and such affirmation covers transactions in debt securities; so long as the member has provided written disclosure to the qualified institutional buyer that the member may provide debt research reports that are intended for institutional

investors and that are not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors. If the qualified institutional buyer does not contact the member to request that such institutional debt research not be provided, the member may reasonably conclude that the qualified institutional buyer has consented to receiving debt institutional research reports; or

(B) a person that meets the definition of "institutional account" in Rule 4512(c); provided that such person, prior to receipt of a debt research report, has affirmatively notified the member in writing that it wishes to receive institutional debt research and forego treatment as a retail investor for the purposes of this Rule.

(2) Notwithstanding paragraph (j)(1) of this Rule, a member must establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage conflicts of interest described in paragraphs (b)(2)(A)(i), (b)(2)(H) (with respect to pressuring), (b)(2)(I), (b)(2)(K), (b)(2)(L), (b)(2)(M), (b)(2)(N) and Supplementary Material .02(a) of this Rule.

(3) Notwithstanding paragraph (j)(1) of this Rule, a member that distributes third-party debt research reports to institutional investors pursuant to this exemption must establish, maintain and enforce written policies and procedures reasonably designed to comply with paragraphs (g)(1), (g)(2), (g)(4) and (g)(6) of this Rule.

(4) Debt research reports provided to institutional investors pursuant to this exemption ("institutional debt research") must disclose prominently on the first page that:

(A) "This document is intended for institutional investors and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors."

(B) If applicable, "The views expressed in this report may differ from the views offered in [Firm's] debt research reports prepared for retail investors."

(C) If applicable, "This report may not be independent of [Firm's] proprietary interests. [Firm] trades the securities covered in this report for its own account and on a discretionary basis on behalf of certain clients. Such trading interests may be contrary to the recommendation(s) offered in this report."

(5) Notwithstanding paragraph (j)(4) of this Rule, a member that distributes third-party debt research reports to institutional investors pursuant to this exemption must disclose prominently the disclosures required by paragraphs (j)(4)(A) and (j)(4)(C) of this Rule.

(6) A member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that institutional debt research is made available only to eligible

institutional investors. A member may not rely on this exemption with respect to a debt research report that the member has reason to believe will be redistributed to a retail investor.

(7) This paragraph (j) does not relieve a member of its obligations to comply with the antifraud provisions of the federal securities laws and FINRA rules.

### **(k) Exemption for Good Cause**

Pursuant to the Rule 9600 Series, FINRA may in exceptional and unusual circumstances, conditionally or unconditionally grant an exemption from any requirement of this Rule for good cause shown after taking into account all relevant factors, to the extent such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest.

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

**.01 Efforts to Solicit Investment Banking Business.** FINRA interprets paragraph (b)(2)(L)(i) of this Rule to prohibit in pitch materials any information about a member's debt research capacity in a manner that suggests, directly or indirectly, that the member might provide favorable debt research coverage. For example, FINRA would consider the publication in a pitch book or related materials of an analyst's industry ranking to imply the potential outcome of future research because of the manner in which such rankings are compiled. On the other hand, a member would be permitted to include in the pitch materials the fact of coverage and the name of the debt research analyst because such information alone does not imply favorable coverage. Members must consider whether the facts and circumstances of any solicitation or engagement would warrant disclosure under Section 17(b) of the Securities Act.

### **.02 Restrictions on Communications with Customers and Internal Personnel**

(a) Consistent with the requirements of paragraph (b)(2)(M) of this Rule, no debt research analyst may engage in any communication with a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction.

(b) FINRA interprets paragraph (b)(1)(C) of this Rule to, among other things, require that any written or oral communication by a debt research analyst with a current or prospective customer or internal personnel related to an investment banking services transaction must be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.

### **.03 Information Barriers between Research Analysts and Trading Desk Personnel**

(a) FINRA interprets paragraph (b)(1)(C) of this Rule to, among other things, require members to establish, maintain and enforce written policies and procedures reasonably designed to prohibit:



(1) Sales and trading and principal trading personnel attempting to influence a debt research analyst's opinion or views for the purpose of benefiting the trading position of the firm, a customer or a class of customers; and

(2) Debt research analysts identifying or recommending specific potential trading transactions to sales and trading or principal trading personnel that are inconsistent with such debt research analyst's currently published debt research reports, or disclosing the timing of, or material investment conclusions in, a pending debt research report.

(b) The following communications between debt research analysts and sales and trading or principal trading personnel are permitted:

(1) Sales and trading and principal trading personnel may communicate customers' interests to a debt research analyst, so long as the debt research analyst does not respond by publishing debt research for the purpose of benefiting the trading position of the firm, a customer or a class of customers;

(2) Debt research analysts may provide customized analysis, recommendations or trade ideas to sales and trading and principal trading personnel and customers, provided that any such communications are not inconsistent with the analyst's currently published or pending debt research, and that any subsequently published debt research is not for the purpose of benefiting the trading position of the firm, a customer or a class of customers;

(3) Sales and trading and principal trading personnel may seek the views of debt research analysts regarding the creditworthiness of the issuer of a debt security and other information regarding an issuer of a debt security that is reasonably related to the price/performance of the debt security, so long as, with respect to any covered issuer, such information is consistent with the debt research analyst's published debt research report and consistent in nature with the types of communications that a debt research analyst might have with customers. In determining what is consistent with the debt research analyst's published debt research, a member may consider the context, including that the investment objectives or time horizons being discussed differ from those underlying the debt research analyst's published views; and

(4) Debt research analysts may seek information from sales and trading and principal trading personnel regarding a particular bond instrument, current prices, spreads, liquidity and similar market information relevant to the debt research analyst's valuation of a particular debt security.

(c) Communications between debt research analysts and sales and trading or principal trading personnel that are not related to sales and trading, principal trading or debt research activities may take place without restriction, unless otherwise prohibited.

**.04 Disclosure of Compensation Received by Affiliates.** A member may satisfy the disclosure requirement in paragraph (c)(4)(D) of this Rule with respect to receipt of non-investment banking services compensation by an affiliate by implementing written policies and procedures reasonably designed to prevent the debt research analyst and associated persons of the member with the ability to influence the content of debt research reports from directly or indirectly receiving information from the affiliate as to whether the affiliate received such compensation. In addition, a member may satisfy the disclosure requirement in paragraph (c)(4)(C) of this Rule with respect to the receipt of investment banking compensation from a foreign sovereign by a non-U.S. affiliate of the member by implementing written policies and procedures reasonably designed to prevent the debt research analyst and associated persons of the member with the ability to influence the content of debt research reports from directly or indirectly receiving information from the non-U.S. affiliate as to whether such non-U.S. affiliate received or expects to receive such compensation from the foreign sovereign. However, a member must disclose compensation received by its affiliates from the subject company (including any foreign sovereign) in the past 12 months when the debt research analyst or an associated person with the ability to influence the content of a debt research report has actual knowledge that an affiliate received such compensation during that time period.

**.05 Submission of Sections of a Draft Research Report for Factual Review.**

Consistent with the requirements of paragraphs (b)(2)(B) and (N) of this Rule, sections of a draft debt research report may be provided to non-investment banking personnel, non-principal trading personnel, non-sales and trading personnel or to the subject company for factual review, if:

(a) the sections of the draft debt research report submitted do not contain the research summary, recommendation or rating;

(b) a complete draft of the debt research report is provided to legal or compliance personnel before sections of the report are submitted to non-investment banking personnel, non-principal trading personnel, non-sales and trading personnel or the subject company; and

(c) if, after submitting sections of the draft debt research report to non-investment banking personnel, non-principal trading personnel, non-sales and trading personnel or the subject company, the research department intends to change the proposed rating or recommendation, it must first provide written justification to, and receive written authorization from, legal or compliance personnel for the change. The member must retain copies of any draft and the final version of such debt research report for three years after publication.

**.06 Distribution of Member Research Products.** With respect to paragraph (f) of this Rule, a member may provide different debt research products and services to different classes of customers. For example, a member may offer one debt research product for those with a long-term investment horizon ("investor research") and a different debt research product for those customers with a short-term investment horizon ("trading research"). These products may lead to different recommendations

or ratings, provided that each is consistent with the meaning of the member's ratings system for each respective product. However, a member may not differentiate a debt research product based on the timing of receipt of a recommendation, rating or other potentially market moving information, nor may a member label a debt research product with substantially the same content as a different debt research product as a means to allow certain customers to trade in advance of other customers. In addition, a member that provides different debt research products and services for different customers must inform its other customers that receive a research product that its alternative debt research products and services may reach different conclusions or recommendations that could impact the price of the debt security. Thus, for example, a member that offers trading research must inform its investment research customers that its trading research product may contain different recommendations or ratings that could result in short-term price movements contrary to the recommendation in its investment research.

**.07 Ability to Influence the Content of a Debt Research Report.** For the purposes of this Rule, an associated person with the ability to influence the content of a debt research report is an associated person who is required to review the content of the debt research report or has exercised authority to review or change the debt research report prior to publication or distribution. This term does not include legal or compliance personnel who may review a debt research report for compliance purposes but are not authorized to dictate a particular recommendation or rating.

**.08 Obligations of Persons Associated with a Member.** Consistent with Rule 0140, persons associated with a member must comply with such member's written policies and procedures as established pursuant to this Rule. In addition, consistent with Rule 0140, it shall be a violation of this Rule for an associated person to engage in the restricted or prohibited conduct to be addressed through the establishment, maintenance and enforcement of written policies and procedures required by this Rule or related Supplementary Material.

**.09 Joint Due Diligence.** FINRA interprets paragraph (b)(1)(C) to prohibit the performance of joint due diligence (i.e., confirming the adequacy of disclosure in offering or other disclosure documents for a transaction) by the debt research analyst in the presence of investment banking department personnel prior to the selection by the issuer of the underwriters for the investment banking services transaction.

**.10 Divesting Research Analyst Holdings.** With respect to paragraph (b)(2)(J)(ii), FINRA shall not consider a research analyst account to have traded in a manner inconsistent with a research analyst's recommendation where a member has instituted a policy that prohibits any research analyst from holding securities, or options on or derivatives of such securities, of the companies in the research analyst's coverage universe; provided that the member establishes a reasonable plan to liquidate such holdings consistent with the principles in paragraph (b)(2)(J)(i) and such plan is approved by the member's legal or compliance department.

**.11 Distribution of Institutional Debt Research During Transition Period.** A member may distribute institutional debt research to any person that meets the definition of "institutional account" in Rule

4512(c), other than a natural person, for a period of up to one-year after July 16, 2015 ("the transition period"). After the transition period, a member must have obtained the necessary consent in either paragraph (j)(1)(A) or (j)(1)(B) to distribute institutional debt research to a person. Natural persons that qualify as an institutional account under Rule 4512(c) must provide affirmative written consent to receive institutional debt research during the year transition period and thereafter. This Supplementary Material .11 shall automatically sunset at the end of the transition period.

**.12 Distribution of Institutional Debt Research to Non-U.S. Investors.** The requirements of paragraphs (j)(1)(A) and (B) of this Rule shall not apply to the distribution of an institutional debt research report by a non-U.S. affiliate of a member to a non-U.S. investor, provided that:

- (a) The non-U.S. investor is not a customer of the member;
- (b) The non-U.S. investor is a customer of the non-U.S. affiliate of the member; and
- (c) The non-U.S. affiliate of the member has a reasonable basis to believe that the customer meets the definition of "institutional account" in Rule 4512(c).

**.13 Distribution of Institutional Debt Research for Informational Purposes**

(a) A member may distribute institutional debt research reports to the persons described in paragraph (c) of this Supplementary Material .13 for informational purposes unrelated to investing in debt securities, provided that the member does not distribute the reports prior to their publication and the member has disclosed that:

(1) The member may provide the recipient debt research reports that were prepared for institutional investors and are not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors; and

(2) The institutional debt research reports would be provided only for informational purposes and not for the purpose of making an investment decision related to debt securities.

(b) If the person receiving institutional debt research pursuant to this Supplementary Material .13 does not contact the member to request that such institutional debt research not be provided, the member may reasonably conclude that the person has consented to receiving debt institutional research according to the terms of this Supplementary Material .13.

(c) Institutional debt research may be distributed for informational purposes unrelated to investing in debt securities pursuant to this Supplementary Material .13 to:

- (1) Regulators for regulatory purposes;
- (2) Academics for academic purposes;

(3) Issuers for the purpose of enhancing knowledge of their industry and competitors and market and economic factors; and

(4) Media organizations for news gathering purposes.

**.14 Public Appearances by Research Analysts.** A member or debt research analyst will not be required to make a disclosure required by paragraph (d) of this Rule where attendance at the public appearance is limited to institutional investors eligible to receive institutional debt research pursuant to paragraph (j) of this Rule. Members must maintain records of public appearances by debt research analysts sufficient to demonstrate that attendance at the public appearance was limited to institutional investors eligible to receive institutional debt research pursuant to paragraph (j) of this Rule. Such records must be maintained for at least three years from the date of the public appearance.

Amended by SR-FINRA-2016-017 eff. July 16, 2016;

Adopted by SR-FINRA-2014-048, SR-FINRA-2016-008, and SR-FINRA-2016-013 eff. July 16, 2016.

**Selected Notice:** 15-31

# 2251. Processing and Forwarding of Proxy and Other Issuer-Related Materials

The Rule

Notices

(a) A member shall process and forward promptly all information as required by this Rule and applicable SEC rules regarding a security to the beneficial owner (or the beneficial owner's designated investment adviser) if the member carries the account in which the security is held for the beneficial owner and the security is registered in a name other than the name of the beneficial owner.

## **(1) Equity Securities**

For an equity security, the member, subject to paragraph (e) of this Rule and applicable SEC rules, shall process and forward:

(A) all proxy material, as provided in paragraph (c) of this Rule, that is furnished to the member by the issuer of the securities or a stockholder of such issuer; and

(B) all annual reports, information statements and other material sent to stockholders that are furnished to the member by the issuer of the securities.

## **(2) Debt Securities**

For a debt security other than a municipal security, the member, subject to paragraph (e) of this Rule and applicable SEC rules, shall make reasonable efforts to process and forward any communication, document, or collection of documents pertaining to the issue that:

(A) was prepared by or on behalf of, the issuer, or was prepared by or on behalf of, the trustee of the specific issue of the security; and

(B) contains material information about such issue including, but not limited to, notices concerning monetary or technical defaults, financial reports, information statements, and material event notices.

(b) No member shall give a proxy to vote stock that is registered in its name, except as required or permitted under the provisions of paragraphs (c) or (d) of this Rule, unless such member is the beneficial owner of such stock.

(c)(1) Whenever an issuer or stockholder of such issuer soliciting proxies shall, subject to paragraph (e) of this Rule and applicable SEC rules, timely furnish to a member:

(A) sufficient copies of all soliciting material that such person is sending to registered holders, and

(B) satisfactory assurance that he or she will reimburse such member for all out-of-pocket expenses, including reasonable clerical expenses incurred by such member in connection with such solicitation, such member shall process and transmit promptly to each beneficial owner of stock of such issuer (or the beneficial owner's designated investment adviser) that is in its possession or control and registered in a name other than the name of the beneficial owner, all such material furnished. Such material shall include a signed proxy indicating the number of shares held for such beneficial owner and bearing a symbol identifying the proxy with proxy records maintained by the member, and a letter informing the beneficial owner (or the beneficial owner's designated investment adviser) of the time limit and necessity for completing the proxy form and processing and forwarding it to the person soliciting proxies prior to the expiration of the time limit in order for the shares to be represented at the meeting. A member shall furnish a copy of the symbols to the person soliciting the proxies and shall also retain a copy thereof pursuant to the provisions of SEA Rule 17a-4.

(2) Notwithstanding the provisions of paragraph (c)(1) of this Rule, a member may give a proxy to vote any stock pursuant to the rules of any national securities exchange of which it is a member provided that the records of the member clearly indicate the procedure it is following.

(3) This paragraph (c) shall not apply to beneficial owners residing outside of the United States, although members may voluntarily comply with the provisions hereof in respect to such persons if they so desire.

(d)(1) A member may give a proxy to vote any stock registered in its name if such member holds such stock as executor, administrator, guardian, trustee, or in a similar representative or fiduciary capacity with authority to vote.

(2) A member that has in its possession or within its control stock registered in the name of another member and that desires to process and transmit signed proxies pursuant to the provisions of paragraph (c) of this Rule, shall obtain the requisite number of signed proxies from such holder of record.

(3) Notwithstanding the foregoing,

(A) any member designated by a named Employee Retirement Income Security Act of 1974 (as amended) ("ERISA") Plan fiduciary as the investment manager of stock held as assets of the ERISA Plan may vote the proxies in accordance with the ERISA Plan fiduciary responsibilities if the ERISA Plan expressly grants discretion to the investment manager to manage, acquire, or dispose of any plan asset and has not expressly reserved the proxy voting right for the named ERISA Plan fiduciary; and

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(B) any designated investment adviser may vote such proxies.

(e)(1) As required in paragraph (a) of this Rule, a member must process and forward promptly the material set forth in paragraph (a)(1), in connection with an equity security, or must make reasonable efforts to process and forward promptly the material set forth in paragraph (a)(2), in connection with a debt security, provided that the member:

(A) is furnished with sufficient copies of the material (e.g., annual reports, information statements or other material sent to security holders) by the issuer, stockholder, or trustee;

(B) is requested by the issuer, stockholder, or trustee to process and forward the material to security holders; and,

(C) receives satisfactory assurance that it will be reimbursed, consistent with [Rule 2251.01](#) and applicable SEC rules, by such issuer, stockholder, or trustee for all out-of-pocket expenses, including reasonable clerical expenses.

(2) This paragraph (e) shall not apply to beneficial owners residing outside of the United States although members may voluntarily comply with the provisions hereof in respect to such persons if they so desire.

(f) For purposes of this Rule, the term "designated investment adviser" is a person registered under the Investment Advisers Act, or registered as an investment adviser under the laws of a state, who exercises investment discretion pursuant to an advisory contract for the beneficial owner and is designated in writing by the beneficial owner to receive proxy and related materials and vote the proxy, and to receive annual reports and other material sent to security holders.

(1) For purposes of this Rule, the term "state" shall have the meaning given to such term in Section 202(a)(19) of the Investment Advisers Act (as the same may be amended from time to time).

(2) The written designation must be signed by the beneficial owner; be addressed to the member; and include the name of the designated investment adviser.

(3) Members that receive such a written designation from a beneficial owner must ensure that the designated investment adviser is registered with the SEC pursuant to the Investment Advisers Act, or with a state as an investment adviser under the laws of such state, and that the investment adviser is exercising investment discretion over the customer's account pursuant to an advisory contract to vote proxies and/or to receive proxy soliciting material, annual reports and other material. Members must keep records substantiating this information.

(4) Beneficial owners have an unqualified right at any time to rescind designation of the investment adviser to receive materials and to vote proxies. The rescission must be in writing and submitted to the member.



(g) The Board of Governors for the guidance of members is authorized to establish a suggested rate of reimbursement of members for expenses incurred in connection with processing and transmitting the proxy solicitation to the beneficial owners of the securities pursuant to paragraph (c) of this Rule or in processing and transmitting information statements or other material to the beneficial owners of securities pursuant to paragraph (e) of this Rule.

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

**.01 Approved Rates of Reimbursement**

(a) The following approved rates of reimbursement for expenses incurred in processing and forwarding proxy material, annual reports, information statements and other material shall be considered reasonable rates of reimbursement. In addition to the charges specified in this Supplementary Material, members also are entitled to receive reimbursement for: (1) actual postage costs (including return postage at the lowest available rate); (2) the actual cost of envelopes (provided they are not furnished by the issuer, the trustee, or a person soliciting proxies); and (3) any actual communication expenses (excluding overhead) incurred in receiving voting returns either telephonically or electronically.

**(1) Basic Processing and Intermediary Unit Fees**

(A) Definitions: For purposes of this Supplementary Material:

(i) the term "nominee" shall mean a broker or bank subject to SEA Rule 14b-1 or Rule 14b-2, respectively;

(ii) the term "intermediary" shall mean a proxy service provider that coordinates the distribution of proxy or other materials for multiple nominees.

(B)

(i) For each set of proxy material, i.e., proxy statement, form of proxy and annual report when processed as a unit, a Processing Unit Fee based on the following schedule according to the number of nominee accounts through which the issuer's securities are beneficially owned:

a. 50 cents for each account up to 10,000 accounts;

b. 47 cents for each account above 10,000 accounts, up to 100,000 accounts;

c. 39 cents for each account above 100,000 accounts, up to 300,000 accounts;

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d. 34 cents for each account above 300,000 accounts, up to 500,000 accounts;

e. 32 cents for each account above 500,000 accounts.

To clarify, under this schedule, a member may charge the issuer the tier one rate for the first 10,000 accounts, or portion thereof, with decreasing rates applicable only on additional accounts in the additional tiers. References in this Supplementary Material to the number of accounts means the number of accounts holding securities of the issuer at any nominee that is providing distribution services without the services of an intermediary, or when an intermediary is involved, the aggregate number of nominee accounts with beneficial ownership in the issuer served by the intermediary.

(ii) In the case of a meeting for which an opposition proxy has been furnished to security holders, the Processing Unit Fee shall be \$1.00 per account, in lieu of the fees in the above schedule.

(C) The following are supplemental fees for intermediaries:

(i) \$22.00 for each nominee served by the intermediary that has at least one account beneficially owning shares in the issuer;

(ii) an Intermediary Unit Fee for each set of proxy material, based on the following schedule according to the number of nominee accounts through which the issuer's securities are beneficially owned:

a. 14 cents for each account up to 10,000 accounts;

b. 13 cents for each account above 10,000 accounts, up to 100,000 accounts;

c. 11 cents for each account above 100,000 accounts, up to 300,000 accounts;

d. 9 cents for each account above 300,000 accounts, up to 500,000 accounts;

e. 7 cents for each account above 500,000 accounts.

To clarify, under this schedule, a member may charge the issuer the tier one rate for the first 10,000 accounts, or portion thereof, with decreasing rates applicable only on additional accounts in the additional tiers.

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(iii) For special meetings, the Intermediary Unit Fee shall be based on the following schedule, in lieu of the fees described in (ii) above:

- a. 19 cents for each account up to 10,000 accounts;
- b. 18 cents for each account above 10,000 accounts, up to 100,000 accounts;
- c. 16 cents for each account above 100,000 accounts, up to 300,000 accounts;
- d. 14 cents for each account above 300,000 accounts, up to 500,000 accounts;
- e. 12 cents for each account above 500,000 accounts.

To clarify, under this schedule, a member may charge the issuer the tier one rate for the first 10,000 accounts, or portion thereof, with decreasing rates applicable only on additional accounts in the additional tiers. For purposes of this paragraph, a special meeting is a meeting other than the issuer's meeting for the election of directors.

(iv) In the case of a meeting for which an opposition proxy has been furnished to security holders, the Intermediary Unit Fee shall be 25 cents per account, with a minimum fee of \$5,000.00 per soliciting entity, in lieu of the fees described in (ii) or (iii) above, as the case may be. Where there are separate solicitations by management and an opponent, the opponent is to be separately billed for the costs of its solicitation.

## **(2) Charges for Proxy Follow-Up Material**

For each set of follow-up material, a Processing Unit Fee of 40 cents per account, except for those relating to an issuer's annual meeting for the election of directors, for which the Processing Unit Fee shall be 20 cents per account.

## **(3) Charge for Providing Beneficial Ownership Information**

Six and one-half cents per name of non-objecting beneficial owner ("NOBO") provided to the issuer pursuant to the issuer's request. Where the non-objecting beneficial ownership information is not furnished directly to the issuer by the member, but is furnished through an agent designated by the member, the issuer will be expected to pay in addition the following fee to the agent:

- (A) 10 cents per name for the first 10,000 names or portion thereof;

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(B) 5 cents per name for additional names up to 100,000 names; and

(C) 4 cents per name above 100,000;

with a minimum fee of \$100 per requested list.

Any member that designates an agent for the purpose of furnishing requesting issuers with beneficial ownership information pursuant to SEA Rule 14b-1(c) and thereafter cancels that designation or appoints a new agent for such purpose should promptly inform interested issuers.

When an issuer requests beneficial ownership information as of a date which is the record date for an annual or special meeting or a solicitation of written shareholder consent, the issuer may ask to eliminate names holding more or less than a specified number of shares, or names of shareholders that have already voted, and the issuer may not be charged a fee for the NOBO names so eliminated. In all other cases the issuer may be charged for all the names in the NOBO list.

#### **(4) Charges for Interim Report, Post Meeting Report and Other Material**

For interim reports, annual reports if processed separately, post meeting reports, or other material, a Processing Unit Fee of 15 cents per account.

#### **(5) Preference Management Fees**

With respect to each account for which the nominee has eliminated the need to send materials in paper format through the mails (or by courier service), a Preference Management Fee in the following amount:

(A) For each set of proxy material described in paragraph (a)(1)(B) of this Supplementary Material, 32 cents; provided, however, that if the account is a Managed Account (as defined in paragraph (a)(7) of this Supplementary Material), the Preference Management Fee shall be 16 cents.

(B) For each set of material described in either paragraph (a)(2) or paragraph (a)(4) of this Supplementary Material, the Preference Management Fee shall be 10 cents.

To clarify, the Preference Management Fee is in addition to, and not in lieu of, the other fees provided for in this Supplementary Material.

#### **(6) Notice and Access Fees**

When an issuer elects to utilize Notice and Access for a proxy distribution, there is an incremental fee based on all nominee accounts through which the issuer's securities are beneficially owned as follows:

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(A) 25 cents for each account up to 10,000 accounts;

(B) 20 cents for each account over 10,000 accounts, up to 100,000 accounts;

(C) 15 cents for each account over 100,000 accounts, up to 200,000 accounts;

(D) 10 cents for each account over 200,000 accounts, up to 500,000 accounts;

(E) 5 cents for each account over 500,000 accounts.

To clarify, under this schedule, a member may charge the issuer the tier one rate for the first 10,000 accounts, or portion thereof, with decreasing rates applicable only on additional accounts in the additional tiers.

Follow up notices will not incur an incremental fee for Notice and Access.

The Notice and Access fees set forth herein will also be charged with respect to the distribution of investment company shareholder reports pursuant to the SEC's "notice and access" rules in relation to such distributions. The Notice and Access fee will not be charged for any account with respect to which an investment company pays a Preference Management Fee in connection with a distribution of investment company shareholder reports.

In calculating the rates at which the issuer will be charged Notice and Access fees for investment company shareholder report distributions, all accounts holding shares of any class of stock of the applicable issuer eligible to receive the same distribution will be aggregated in determining the appropriate pricing tier under this Supplementary Material .01(a)(6).

No incremental fee will be imposed for fulfillment transactions (i.e., a full package sent to a notice recipient at the recipient's request), although out of pocket costs such as postage will be passed on as in ordinary distributions.

#### **(7) Fee Exclusion in Certain Circumstances**

Notwithstanding any other provision of this Supplementary Material, no fee shall be imposed for a nominee account that is a Managed Account (as hereinafter defined) and contains five or fewer shares or units of the security involved.

For purposes of this Supplementary Material, the term "Managed Account" shall mean an account at a nominee which is invested in a portfolio of securities selected by a professional adviser, and for which the account holder is charged a separate asset-based fee for a range of services which may include ongoing advice, custody and execution services. The adviser can be either employed by or affiliated with the nominee, or a separate investment advisor contracted for the purpose of selecting investment portfolios for the managed account. Requiring that investments or changes to the account be approved by the client shall not preclude an account

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from being a "Managed Account," nor shall the fact that commissions or transaction-based charges are imposed in addition to the asset-based fee.

Notwithstanding any other provision of this Supplementary Material, no fee shall be imposed for any nominee account which contains only a fractional share, i.e., less than one share or unit of the security involved.

Further, notwithstanding any other provision of this Supplementary Material, no fee shall be imposed for a nominee account that contains only shares or units of the securities involved that were transferred to the account holder by the member at no cost.

#### **(8) Enhanced Brokers' Internet Platform Fee**

During the period ending December 31, 2018, there shall be a supplemental fee of 99 cents for each new account that elects, and each full package recipient among a brokerage firm's accounts that converts to, electronic delivery while having access to an Enhanced Brokers' Internet Platform ("EBIP"). This fee does not apply to electronic delivery consents captured by issuers (for example, through an open-enrollment program), nor to positions held in Managed Accounts (as defined in paragraph (a)(7) of this Supplementary Material) nor to accounts voted by investment managers using electronic voting platforms. This is a one-time fee, meaning that an issuer may be billed this fee by a particular member only once for each account covered by this Rule. Billing for this fee should be separately indicated on the issuer's invoice and must await the next proxy or consent solicitation by the issuer that follows the triggering election of electronic delivery by an eligible account. Accounts receiving a notice pursuant to the use of notice and access by the issuer, and accounts to which mailing is suppressed by householding, will not trigger the fee under this Supplementary Material.

To qualify under this Supplementary Material, an EBIP must provide notices of upcoming corporate votes (including record and shareholder meeting dates) and the ability to access proxy materials and a voting instruction form, and cast the vote, through the investor's account page on the member's website without an additional log-in.

Any member that is not also a member of the NYSE with a qualifying EBIP must provide notice thereof to FINRA, including the date such EBIP became operational, and any limitations on the availability of the EBIP to its customers.

Conversions to electronic delivery by accounts with access to an EBIP need to be tracked for the purpose of reporting the activity to FINRA when requested, as do records of marketing efforts to encourage account holders to use the EBIP. In addition, records need to be maintained and reported to FINRA when requested regarding the proportion of non-institutional accounts that vote proxies after being provided access to an EBIP.

(b) Any charges for forwarding pursuant to this Supplementary Material must be reasonable.

Members may request reimbursement of expenses at less than the approved rates; however, no member may seek reimbursement at rates higher than the approved rates or for items or services not specifically enumerated in paragraph (a) of this Supplementary Material without the prior notification to and consent of the person soliciting proxies or the company.

(c) For purposes of this Rule, members are not required to process and transmit more than one annual report, interim report, proxy statement or other material to beneficial owners with more than one account (including trust accounts). In addition, members may eliminate multiple transmissions of reports, statements or other materials to beneficial owners having the same address, provided they comply with SEA Rule 14b-1 and other applicable SEC rules.

**.02 Investment Adviser Registration.** For purposes of this Rule, members may verify registration of an investment adviser through the use of the Investment Adviser Registration Depository ("IARD").

Amended by SR-FINRA-2021-032 eff. Dec. 7, 2021.  
Amended by SR-FINRA-2013-056 eff. Jan. 1, 2014.  
Amended by SR-FINRA-2010-002 eff. Feb. 15, 2010.  
Amended by SR-FINRA-2009-066 eff. Feb. 15, 2010.  
Amended by SR-NASD-2002-124 eff. June 16 2003.  
Amended by SR-NASD-2003-19 eff. Feb 12, 2003.  
Amended by SR-NASD-2002-11 eff. July 9, 2002.  
Amended by SR-NASD-95-06 eff. May 5, 1995.  
Amended by SR-NASD-91-20 eff. Sept. 14, 1991.  
Amended by SR-NASD-86-10 eff. May 30, 1986; Aug, 7, 1991.  
Amended by SR-NASD-86-09 eff. Apr. 29, 1986.  
Amended by SR-NASD-85-07 eff. April 1, 1985.  
Amended eff. Mar. 31, 1974; May 1, 1980.  
Adopted eff. Jan. 2, 1969.

**Selected Notices:** [85-26](#), [86-35](#), [86-46](#), [91-57](#), [92-17](#), [95-45](#), [02-33](#), [03-26](#), [09-72](#), [14-03](#), [22-02](#).

## 2261. Disclosure of Financial Condition

The Rule

Notices

(a) A member shall make available to inspection by any bona fide regular customer, upon request, the information relative to such member's financial condition as disclosed in its most recent balance sheet prepared either in accordance with such member's usual practice or as required by any state or federal securities laws, or any rule or regulation thereunder. In lieu of making such balance sheet available to inspection, a member may deliver the balance sheet to the requesting bona fide regular customer in paper or electronic form; provided that, with respect to electronic delivery, the customer must consent to receive the balance sheet in electronic form.

(b) Any member who is a party to an open transaction or who has on deposit cash or securities of another member shall deliver upon written request of the other member, in paper or electronic form, a statement of its financial condition as disclosed in its most recent balance sheet prepared either in accordance with such member's usual practice or as required by any state or federal securities laws, or any rule or regulation thereunder.

(c) As used in paragraph (a) of this Rule, the term "customer" means any person who, in the regular course of such member's business, has cash or securities in the possession of such member.

Amended by SR-FINRA-2009-081, eff. June 14, 2010.

**Selected Notice:** 10-21.



# 2262. Disclosure of Control Relationship with Issuer

The Rule

Notices

A member controlled by, controlling, or under common control with, the issuer of any security, shall, before entering into any contract with or for a customer for the purchase or sale of such security, disclose to such customer the existence of such control, and if such disclosure is not made in writing, it shall be supplemented by the giving or sending of written disclosure at or before the completion of the transaction.

Amended by SR-FINRA-2009-044 eff. Dec. 14, 2009.

**Selected Notice:** 09-60.

# 2263. Arbitration Disclosure to Associated Persons Signing or Acknowledging Form U4

The Rule

Notices

A member shall provide an associated person with the following written statement whenever the associated person is asked, pursuant to FINRA [Rule 1010](#), to sign an initial or amended Form U4, or otherwise provide written (which may be electronic) acknowledgment of an amendment to the Form U4:

The Form U4 contains a predispute arbitration clause. It is in item 5 of Section 15A of the Form U4. You should read that clause now. Before signing the Form U4, you should understand the following:

(1) You are agreeing to arbitrate any dispute, claim or controversy that may arise between you and your firm, or a customer, or any other person that is required to be arbitrated under the rules of the self-regulatory organizations with which you are registering. This means you are giving up the right to sue a member, customer, or another associated person in court, including the right to a trial by jury, except as provided by the rules of the arbitration forum in which a claim is filed.

(2) A claim alleging employment discrimination in violation of a statute is not required to be arbitrated under FINRA rules. Such a claim may be arbitrated at FINRA only if the parties have agreed to arbitrate it, either before or after the dispute arose. The rules of other arbitration forums may be different.

(3) A dispute arising under a whistleblower statute that prohibits the use of predispute arbitration agreements is not required to be arbitrated under FINRA rules. Such a dispute may be arbitrated only if the parties have agreed to arbitrate it after the dispute arose.

(4) A party alleging a sexual assault claim or sexual harassment claim that has agreed to arbitrate before the dispute arose may elect post dispute not to arbitrate such a claim under the Code. Such a claim may be arbitrated if the parties have agreed to arbitrate it after the dispute arose.

(5) Arbitration awards are generally final and binding; a party's ability to have a court reverse or modify an arbitration award is very limited.

(6) The ability of the parties to obtain documents, witness statements and other discovery is generally more limited in arbitration than in court proceedings.

(7) The arbitrators do not have to explain the reason(s) for their award unless, in an eligible case, a joint request for an explained decision has been submitted by all parties to the panel at least

20 days prior to the first scheduled hearing date.

(8) The panel of arbitrators may include arbitrators who were or are affiliated with the securities industry or public arbitrators, as provided by the rules of the arbitration forum in which a claim is filed.

(9) The rules of some arbitration forums may impose time limits for bringing a claim in arbitration. In some cases, a claim that is ineligible for arbitration may be brought in court.

Amended by SR-FINRA-2022-012 eff. May 13, 2022.

Amended by SR-FINRA-2021-003 eff. Feb. 23, 2021.

Amended by SR-FINRA-2011-067 eff. May 21, 2012.

Amended by SR-FINRA-2009-019 eff. Sep. 25, 2009.

Amended by SR-NASD-2006-046 eff. April 03, 2006.

Adopted by SR-NASD-99-08 eff. Jan. 18, 2000.

**Selected Notices:** [99-96](#), [09-40](#), [12-21](#), [22-15](#).

# 2264. Margin Disclosure Statement

The Rule

Notices

(a) No member shall open a margin account, as specified in Regulation T of the Board of Governors of the Federal Reserve System, for or on behalf of a non-institutional customer, unless, prior to or at the time of opening the account, the member has furnished to the customer, individually, in paper or electronic form, and in a separate document (or contained by itself on a separate page as part of another document), the margin disclosure statement specified in this paragraph (a). In addition, any member that permits non-institutional customers either to open accounts online or to engage in transactions in securities online must post such margin disclosure statement on the member's Web site in a clear and conspicuous manner.

## Margin Disclosure Statement

Your brokerage firm is furnishing this document to you to provide some basic facts about purchasing securities on margin, and to alert you to the risks involved with trading securities in a margin account. Before trading stocks in a margin account, you should carefully review the margin agreement provided by your firm. Consult your firm regarding any questions or concerns you may have with your margin accounts.

When you purchase securities, you may pay for the securities in full or you may borrow part of the purchase price from your brokerage firm. If you choose to borrow funds from your firm, you will open a margin account with the firm. The securities purchased are the firm's collateral for the loan to you. If the securities in your account decline in value, so does the value of the collateral supporting your loan, and, as a result, the firm can take action, such as issue a margin call and/or sell securities or other assets in any of your accounts held with the member, in order to maintain the required equity in the account.

It is important that you fully understand the risks involved in trading securities on margin. These risks include the following:

- **You can lose more funds than you deposit in the margin account.** A decline in the value of securities that are purchased on margin may require you to provide additional funds to the firm that has made the loan to avoid the forced sale of those securities or other securities or assets in your account(s).
- **The firm can force the sale of securities or other assets in your account(s).** If the equity in your account falls below the maintenance margin requirements, or the firm's higher "house" requirements, the firm can sell the securities or other assets in any of your

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accounts held at the firm to cover the margin deficiency. You also will be responsible for any short fall in the account after such a sale.

- **The firm can sell your securities or other assets without contacting you.** Some investors mistakenly believe that a firm must contact them for a margin call to be valid, and that the firm cannot liquidate securities or other assets in their accounts to meet the call unless the firm has contacted them first. This is not the case. Most firms will attempt to notify their customers of margin calls, but they are not required to do so. However, even if a firm has contacted a customer and provided a specific date by which the customer can meet a margin call, the firm can still take necessary steps to protect its financial interests, including immediately selling the securities without notice to the customer.
- **You are not entitled to choose which securities or other assets in your account(s) are liquidated or sold to meet a margin call.** Because the securities are collateral for the margin loan, the firm has the right to decide which security to sell in order to protect its interests.
- **The firm can increase its "house" maintenance margin requirements at any time and is not required to provide you advance written notice.** These changes in firm policy often take effect immediately and may result in the issuance of a maintenance margin call. Your failure to satisfy the call may cause the member to liquidate or sell securities in your account(s).
- **You are not entitled to an extension of time on a margin call.** While an extension of time to meet margin requirements may be available to customers under certain conditions, a customer does not have a right to the extension.

(b) Members shall, with a frequency of not less than once a calendar year, deliver individually, in paper or electronic form, the disclosure statement described in paragraph (a) or the following bolded disclosures to all non-institutional customers with margin accounts:

Securities purchased on margin are the firm's collateral for the loan to you. If the securities in your account decline in value, so does the value of the collateral supporting your loan, and, as a result, the firm can take action, such as issue a margin call and/or sell securities or other assets in any of your accounts held with the member, in order to maintain the required equity in the account. It is important that you fully understand the risks involved in trading securities on margin. These risks include the following:

- **You can lose more funds than you deposit in the margin account.**
- **The firm can force the sale of securities or other assets in your account(s).**
- **The firm can sell your securities or other assets without contacting you.**

- **You are not entitled to choose which securities or other assets in your account(s) are liquidated or sold to meet a margin call.**
- **The firm can increase its "house" maintenance margin requirements at any time and is not required to provide you advance written notice.**
- **You are not entitled to an extension of time on a margin call.**

The annual disclosure statement required pursuant to this paragraph (b) may be delivered within or as part of other account documentation, and is not required to be provided in a separate document or on a separate page.

(c) In lieu of providing the disclosures specified in paragraphs (a) and (b), a member may provide to the customer and, to the extent required under paragraph (a) post on its Web site, an alternative disclosure statement, provided that the alternative disclosures shall be substantially similar to the disclosures specified in paragraphs (a) and (b).

(d) For purposes of this Rule, the term "non-institutional customer" means a customer that does not qualify as an "institutional account" under Rule 4512(c).

Amended by SR-FINRA-2011-065 eff. Dec. 5, 2011.  
Amended by SR-FINRA-2009-52 eff. Dec. 14, 2009.  
Amended by SR-NASD-2002-69 eff. July 1, 2002.  
Adopted by SR-NASD-2000-55 eff. June 4, 2001.

**Selected Notices:** 01-31, 02-35, 09-60.

# 2265. Extended Hours Trading Risk Disclosure

The Rule

Notices

(a) No member shall permit a customer to engage in extended hours trading unless the member has furnished to the customer, individually, in paper or electronic form, a disclosure statement highlighting the risks specific to extended hours trading. In addition, any member that permits customers either to open accounts on-line in which such customer may engage in extended hours trading or to engage in extended hours trading in securities on-line, must post an extended hours trading risk disclosure statement on the member's Web site in a clear and conspicuous manner.

## **Model Extended Hours Trading Risk Disclosure Statement**

You should consider the following points before engaging in extended hours trading. "Extended hours trading" means trading outside of "regular trading hours." "Regular trading hours" generally means the time between 9:30 a.m. and 4:00 p.m. Eastern Standard Time.

- **Risk of Lower Liquidity.** Liquidity refers to the ability of market participants to buy and sell securities. Generally, the more orders that are available in a market, the greater the liquidity. Liquidity is important because with greater liquidity it is easier for investors to buy or sell securities, and as a result, investors are more likely to pay or receive a competitive price for securities purchased or sold. There may be lower liquidity in extended hours trading as compared to regular trading hours. As a result, your order may only be partially executed, or not at all.
- **Risk of Higher Volatility.** Volatility refers to the changes in price that securities undergo when trading. Generally, the higher the volatility of a security, the greater its price swings. There may be greater volatility in extended hours trading than in regular trading hours. As a result, your order may only be partially executed, or not at all, or you may receive an inferior price when engaging in extended hours trading than you would during regular trading hours.
- **Risk of Changing Prices.** The prices of securities traded in extended hours trading may not reflect the prices either at the end of regular trading hours, or upon the opening the next morning. As a result, you may receive an inferior price when engaging in extended hours trading than you would during regular trading hours.
- **Risk of Unlinked Markets.** Depending on the extended hours trading system or the time of day, the prices displayed on a particular extended hours trading system may not reflect the prices in other concurrently operating extended hours trading systems dealing in the same

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securities. Accordingly, you may receive an inferior price in one extended hours trading system than you would in another extended hours trading system.

- **Risk of News Announcements.** Normally, issuers make news announcements that may affect the price of their securities after regular trading hours. Similarly, important financial information is frequently announced outside of regular trading hours. In extended hours trading, these announcements may occur during trading, and if combined with lower liquidity and higher volatility, may cause an exaggerated and unsustainable effect on the price of a security.
- **Risk of Wider Spreads.** The spread refers to the difference in price between what you can buy a security for and what you can sell it for. Lower liquidity and higher volatility in extended hours trading may result in wider than normal spreads for a particular security.

(b) In lieu of providing the model disclosure statement set forth in paragraph (a), a member may furnish customers with an alternative disclosure statement, provided that such alternative disclosure statement is substantially similar to the model disclosure statement set forth in paragraph (a) addressing, at a minimum, the above six risks.

(c) Members must consider whether to develop and include additional disclosures in the extended hours trading risk disclosure statement as necessary to address product-specific or other specific needs. For example, members may need to develop additional disclosures to address such issues as exchange-traded funds, options trading, options exercises, and the effect of stock splits or dividend payments during extended-hours trading.

Adopted by SR-FINRA-2009-021 eff. Mar. 27, 2009.



## 2266. SIPC Information

The Rule

Notices

All members, except those members: (a) that pursuant to Section 3(a)(2)(A)(i) through (iii) of the Securities Investor Protection Act of 1970 (SIPA) are excluded from membership in the Securities Investor Protection Corporation (SIPC) and that are not SIPC members; or (b) whose business consists exclusively of the sale of investments that are ineligible for SIPC protection, shall advise all new customers, in writing, at the opening of an account, that they may obtain information about SIPC, including the SIPC brochure, by contacting SIPC, and also shall provide the Web site address and telephone number of SIPC. In addition, such members shall provide all customers with the same information, in writing, at least once each year. In cases where both an introducing firm and clearing firm service an account, the firms may assign these requirements to one of the firms.

Amended by SR-FINRA-2009-016 eff. Aug. 17, 2009.  
Amended by SR-NASD-2007-036 eff. Nov 6, 2007.  
Adopted by SR-NASD-2006-124 eff. Nov 6, 2007.

**Selected Notice:** 07-29, 09-33.

# 2267. Investor Education and Protection

The Rule

Notices

(a) Except as otherwise provided in this Rule, each member shall once every calendar year provide in writing (which may be electronic) to each customer the following items of information:

(1) FINRA BrokerCheck Hotline Number;

(2) FINRA Web site address; and

(3) A statement as to the availability to the customer of an investor brochure that includes information describing FINRA BrokerCheck.

(b) Notwithstanding the requirement in paragraph (a) of this Rule,

(1) any member whose contact with customers is limited to introducing customer accounts to be held directly at an entity other than a FINRA member and thereafter does not carry customer accounts or hold customer funds and securities may furnish a customer with the information required by paragraph (a) of this Rule at or prior to the time of the customer's initial purchase, in lieu of once every calendar year; and

(2) any member that does not have customers or is a party to a carrying agreement where the carrying firm member complies with paragraph (a) of this Rule is exempt from the requirements of this Rule.

Amended by SR-FINRA-2008-062 eff. Aug. 17, 2009.

Amended by SR-NASD-97-75 eff. Oct. 14, 1997.

Adopted by SR-NASD-97-10 eff. Sept. 10, 1997.

**Selected Notice:** 09-33.

# 2268. Requirements When Using Predispute Arbitration Agreements for Customer Accounts

The Rule

Notices

(a) Any predispute arbitration clause shall be highlighted and shall be immediately preceded by the following language in outline form.

This agreement contains a predispute arbitration clause. By signing an arbitration agreement the parties agree as follows:

(1) All parties to this agreement are giving up the right to sue each other in court, including the right to a trial by jury, except as provided by the rules of the arbitration forum in which a claim is filed.

(2) Arbitration awards are generally final and binding; a party's ability to have a court reverse or modify an arbitration award is very limited.

(3) The ability of the parties to obtain documents, witness statements and other discovery is generally more limited in arbitration than in court proceedings.

(4) The arbitrators do not have to explain the reason(s) for their award unless, in an eligible case, a joint request for an explained decision has been submitted by all parties to the panel at least 20 days prior to the first scheduled hearing date.

(5) The panel of arbitrators may include a minority of arbitrators who were or are affiliated with the securities industry.

(6) The rules of some arbitration forums may impose time limits for bringing a claim in arbitration. In some cases, a claim that is ineligible for arbitration may be brought in court.

(7) The rules of the arbitration forum in which the claim is filed, and any amendments thereto, shall be incorporated into this agreement.

(b)(1) In any agreement containing a predispute arbitration agreement, there shall be a highlighted statement immediately preceding any signature line or other place for indicating agreement that states that the agreement contains a predispute arbitration clause. The statement shall also indicate at what page and paragraph the arbitration clause is located.

(2) Within thirty days of signing, a copy of the agreement containing any such clause shall be given to the customer who shall acknowledge receipt thereof on the agreement or on a separate document.

(c)(1) A member shall provide a customer with a copy of any predispute arbitration clause or customer agreement executed between the customer and the member, or inform the customer that the member does not have a copy thereof, within ten business days of receipt of the customer's request. If a customer requests such a copy before the member has provided the customer with a copy pursuant to paragraph (b)(2) above, the member must provide a copy to the customer by the earlier date required by this paragraph (c)(1) or by paragraph (b)(2).

(2) Upon request by a customer, a member shall provide the customer with the names of, and information on how to contact or obtain the rules of, all arbitration forums in which a claim may be filed under the agreement.

(d) No predispute arbitration agreement shall include any condition that:

(1) limits or contradicts the rules of any self-regulatory organization;

(2) limits the ability of a party to file any claim in arbitration;

(3) limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement;

(4) limits the ability of arbitrators to make any award.

(e) If a customer files a complaint in court against a member that contains claims that are subject to arbitration pursuant to a predispute arbitration agreement between the member and the customer, the member may seek to compel arbitration of the claims that are subject to arbitration. If the member seeks to compel arbitration of such claims, the member must agree to arbitrate all of the claims contained in the complaint if the customer so requests.

(f) All agreements shall include a statement that "No person shall bring a putative or certified class action to arbitration, nor seek to enforce any pre-dispute arbitration agreement against any person who has initiated in court a putative class action; or who is a member of a putative class who has not opted out of the class with respect to any claims encompassed by the putative class action until: (i) the class certification is denied; or (ii) the class is decertified; or (iii) the customer is excluded from the class by the court. Such forbearance to enforce an agreement to arbitrate shall not constitute a waiver of any rights under this agreement except to the extent stated herein."

(g) The provisions of this Rule shall become effective on May 1, 2005. The provisions of paragraph (c) shall apply to all members as of the effective date of this Rule regardless of when the customer agreement in question was executed. Otherwise, agreements signed by a customer before May 1, 2005 are subject to the provisions of this Rule in effect at the time the agreement was signed.

Amended by SR-NASD-92-28 eff. Oct. 28, 1992.

Adopted by SR-NASD-89-19 eff. May 10, 1989.

**Selected Notices:** 89-21, 89-58, 92-37, 92-65, 95-16, 95-85, 05-09, 05-32, 11-19.

# 2269. Disclosure of Participation or Interest in Primary or Secondary Distribution

The Rule

Notices

A member who is acting as a broker for a customer or for both such customer and some other person, or a member who is acting as a dealer and who receives or has promise of receiving a fee from a customer for advising such customer with respect to securities, shall, at or before the completion of any transaction for or with such customer in any security in the primary or secondary distribution of which such member is participating or is otherwise financially interested, give such customer written notification of the existence of such participation or interest.

Amended by SR-FINRA-2009-044 eff. Dec. 14, 2009.

**Selected Notice:** 09-60.

# 2270. Day-Trading Risk Disclosure Statement

The Rule

Notices

(a) Except as provided in paragraph (b), no member that is promoting a day-trading strategy, directly or indirectly, shall open an account for or on behalf of a non-institutional customer unless, prior to opening the account, the member has furnished to each customer, individually, in paper or electronic form, the disclosure statement specified in this paragraph (a). In addition, any member that is promoting a day-trading strategy, directly or indirectly, must post such disclosure statement on the member's Web site in a clear and conspicuous manner.

## Day-Trading Risk Disclosure Statement

You should consider the following points before engaging in a day-trading strategy. For purposes of this notice, a "day-trading strategy" means an overall trading strategy characterized by the regular transmission by a customer of intra-day orders to effect both purchase and sale transactions in the same security or securities.

**Day trading can be extremely risky.** Day trading generally is not appropriate for someone of limited resources and limited investment or trading experience and low risk tolerance. You should be prepared to lose all of the funds that you use for day trading. In particular, you should not fund day-trading activities with retirement savings, student loans, second mortgages, emergency funds, funds set aside for purposes such as education or home ownership, or funds required to meet your living expenses. Further, certain evidence indicates that an investment of less than \$50,000 will significantly impair the ability of a day trader to make a profit. Of course, an investment of \$50,000 or more will in no way guarantee success.

**Be cautious of claims of large profits from day trading.** You should be wary of advertisements or other statements that emphasize the potential for large profits in day trading. Day trading can also lead to large and immediate financial losses.

**Day trading requires knowledge of securities markets.** Day trading requires in-depth knowledge of the securities markets and trading techniques and strategies. In attempting to profit through day trading, you must compete with professional, licensed traders employed by securities firms. You should have appropriate experience before engaging in day trading.

**Day trading requires knowledge of a firm's operations.** You should be familiar with a securities firm's business practices, including the operation of the firm's order execution systems and procedures. Under certain market conditions, you may find it difficult or impossible to liquidate a position quickly at a reasonable price. This can occur, for example, when the market for a stock suddenly drops, or if trading is halted due to recent news events or unusual trading activity. The more

volatile a stock is, the greater the likelihood that problems may be encountered in executing a transaction. In addition to normal market risks, you may experience losses due to system failures.

**Day trading will generate substantial commissions, even if the per trade cost is low.** Day trading involves aggressive trading, and generally you will pay commissions on each trade. The total daily commissions that you pay on your trades will add to your losses or significantly reduce your earnings. For instance, assuming that a trade costs \$16 and an average of 29 transactions are conducted per day, an investor would need to generate an annual profit of \$111,360 just to cover commission expenses.

**Day trading on margin or short selling may result in losses beyond your initial investment.** When you day trade with funds borrowed from a firm or someone else, you can lose more than the funds you originally placed at risk. A decline in the value of the securities that are purchased may require you to provide additional funds to the firm to avoid the forced sale of those securities or other securities in your account. Short selling as part of your day-trading strategy also may lead to extraordinary losses, because you may have to purchase a stock at a very high price in order to cover a short position.

**Potential Registration Requirements.** Persons providing investment advice for others or managing securities accounts for others may need to register as either an "Investment Adviser" under the Investment Advisers Act of 1940 or as a "Broker" or "Dealer" under the Securities Exchange Act of 1934. Such activities may also trigger state registration requirements.

(b) In lieu of providing the disclosure statement specified in paragraph (a), a member that is promoting a day-trading strategy may provide to the customer, individually, in paper or electronic form, prior to opening the account, and post on its Web site, an alternative disclosure statement, provided that:

(1) The alternative disclosure statement shall be substantially similar to the disclosure statement specified in paragraph (a); and

(2) The alternative disclosure statement shall be filed with FINRA's Advertising Department (Department) for review at least 10 days prior to use (or such shorter period as the Department may allow in particular circumstances) for approval and, if changes are recommended by FINRA, shall be withheld from use until any changes specified by FINRA have been made or, if expressly disapproved, until the alternative disclosure statement has been refiled for, and has received, FINRA approval. The member must provide with each filing the anticipated date of first use.

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

(1) "Day-trading strategy" shall have the meaning provided in Rule 2130(e).



(2) "Non-institutional customer" means a customer that does not qualify as an "institutional account" under Rule 4512(c).

(3) "Promoting a day-trading strategy" shall have the meaning provided in Rule 2130.01.

••• **Supplementary Material:** -----

**.01 Review by FINRA's Advertising Regulation Department.** A member may submit its retail communications to FINRA's Advertising Regulation Department for review and guidance on whether the content of the retail communications constitutes "promoting a day-trading strategy" for purposes of this Rule.

**.02 Additional Rules Regarding Day Trading.** Members should be aware that, in addition to general rules that may apply, FINRA has additional rules that specifically address day trading. See, e.g., Rule 2130 (Approval Procedures for Day-Trading Accounts); Rule 4210(f)(8)(B) (Margin Requirements) regarding special margin requirements for day trading.

Amended by SR-FINRA-2013-001 eff. Feb. 4, 2013.  
Amended by SR-FINRA-2011-065 eff. Dec. 5, 2011.  
Amended by SR-FINRA-2010-060 eff. Dec. 15, 2010.  
Amended by SR-FINRA-2009-059 eff. Feb. 15, 2010.  
Amended by SR-NASD-2002-69 eff. July 1, 2002.  
Adopted by SR-NASD-99-41 eff. Oct. 16, 2000.

**Selected Notices:** 00-62, 02-35, 09-72.

## 2272. Sales and Offers of Sales of Securities on Military Installations

### (a) Military Installations

For purposes of this Rule, a "Military Installation" shall mean any federally owned, leased or operated base, reservation, post, camp, building or other facility to which members of the U.S. Armed Forces are assigned for duty, including barracks, transient housing and family quarters.

### (b) Disclosures

A member engaging in sales or offers of sales of securities on the premises of a Military Installation to any member in the U.S. Armed Forces or a dependent thereof shall clearly and conspicuously disclose in writing, which may be electronic, to such potential investor prior to engaging in sales or offers of sales of securities to such potential investor:

(1) the identity of the member offering the securities; and

(2) that the securities offered are not being offered or provided by the member on behalf of the Federal Government, and that the offer of such securities is not sanctioned, recommended or encouraged by the Federal Government.

### (c) Suitability

A member shall satisfy the suitability obligations imposed by Rule 2111 when making a recommendation on the premises of a Military Installation to any member of the U.S. Armed Forces or a dependent thereof.

### (d) Fees and Compensation

No member shall cause a person to receive a referral fee or incentive compensation in connection with sales or offers of sales of securities on the premises of a Military Installation with any member of the U.S. Armed Forces or a dependent thereof, unless such person is an associated person of a registered broker-dealer who is appropriately qualified consistent with FINRA rules, and the payment complies with applicable federal securities laws and FINRA rules.

Amended by SR-FINRA-2015-050 eff. Mar. 30, 2016.  
Adopted by SR-FINRA-2015-009 eff. Mar. 30, 2016.

**Selected Notice:** 15-34

# 2273. Educational Communication Related to Recruitment Practices and Account Transfers

The Rule

Notices

## (a) Educational Communication Delivery Requirement

A member that hires or associates with a registered person shall provide to a former customer of the registered person, individually, in paper or electronic form, an educational communication prepared by FINRA when (1) the member, directly or through that registered person, individually contacts the former customer of that registered person to transfer assets or (2) the former customer of that registered person, absent individualized contact, transfers assets to an account assigned, or to be assigned, to the registered person at the member.

## (b) Means and Timing of Delivery

(1) A member shall deliver the communication in paragraph (a) at the time of first individualized contact with a former customer by the registered person or the member regarding the former customer transferring assets to the member.

(A) If the contact is in writing, the written communication required in paragraph (a) must accompany the written communication. If the contact is by electronic communication, the member may hyperlink directly to the educational communication.

(B) If the contact is oral, the member or registered person must notify the former customer orally that an educational communication that includes important considerations in deciding whether to transfer assets to the member will be provided not later than three business days after the contact. The educational communication must be sent within three business days from such oral contact or with any other documentation sent to the former customer related to transferring assets to the member, whichever is earlier.

(2) If a former customer attempts to transfer assets to an account assigned, or to be assigned, to the registered person at the member, but no individualized contact with the former customer by the registered person or member occurs before the former customer seeks to transfer assets, the member shall deliver the educational communication in paragraph (a) to the former customer with the account transfer approval documentation.

(3) The delivery of the communication required by paragraph (a) shall apply for a period of three months following the date the registered person begins employment or associates with the member.

••• **Supplementary Material:**-----

**.01 Definition.** For the purpose of this Rule, the term “former customer” shall mean any customer that had a securities account assigned to a registered person at the registered person's previous firm. This term shall not include an account of a non-natural person that meets the definition of an institutional account pursuant to Rule 4512(c).

**.02 Express Rejection by Former Customer.** The requirement in paragraph (a) shall not apply when the former customer who the member, directly or through that registered person, individually contacts to transfer assets expressly states that he or she is not interested in transferring assets to the member. If the former customer subsequently decides to transfer assets to the member without further individualized contact within the period of three months following the date the registered person begins employment or associates with the member, then the requirements of paragraph (b)(2) shall apply.

Adopted by [SR-FINRA-2015-057](#) eff. Nov. 11, 2016.

**Selected Notice:** [16-18](#).

# 2310. Direct Participation Programs

The Rule

Notices

## (a) Definitions

For the purposes of this Rule, the following terms shall have the stated meanings:

(1) **Affiliate** — when used with respect to a member or sponsor, shall mean any person which controls, is controlled by, or is under common control with, such member or sponsor and includes:

(A) any partner, officer or director (or person performing similar functions) of (i) such member or sponsor, or (ii) a person which beneficially owns 50% or more of the equity interest in, or has the power to vote 50% or more of the voting interest in, such member or sponsor;

(B) any person which beneficially owns or has the right to acquire 10% or more of the equity interest in or has the power to vote 10% or more of the voting interest in (i) such member or sponsor, or (ii) a person which beneficially owns 50% or more of the equity interest in, or has the power to vote 50% or more of the voting interest in, such member or sponsor;

(C) any person with respect to which such member or sponsor, the persons specified in subparagraph (A) or (B), and the immediate families of partners, officers or directors (or persons performing similar functions) specified in subparagraph (A), or other person specified in subparagraph (B), in the aggregate beneficially own or have the right to acquire 10% or more of the equity interest or have the power to vote 10% or more of the voting interest;

(D) any person an officer of which is also a person specified in subparagraph (A) or (B) and any person a majority of the board of directors of which is comprised of persons specified in subparagraph (A) or (B); or

(E) any person controlled by a person or persons specified in subparagraphs (A), (B), (C) or (D).

(2) **Cash available for distribution** — cash flow less amount set aside for restoration or creation of reserves.

(3) **Cash flow** — cash funds provided from operations, including lease payments on net leases from builders and sellers, without deduction for depreciation, but after deducting cash

funds used to pay all other expenses, debt payments, capital improvements and replacements.

(4) Direct participation program (program) — a program which provides for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution including, but not limited to, oil and gas programs, real estate programs, agricultural programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof. A program may be composed of one or more legal entities or programs but when used herein and in any rules or regulations adopted pursuant hereto the term shall mean each of the separate entities or programs making up the overall program and/or the overall program itself. Excluded from this definition are real estate investment trusts, tax qualified pension and profit sharing plans pursuant to Sections 401 and 403(a) of the Internal Revenue Code and individual retirement plans under Section 408 of that Code, tax sheltered annuities pursuant to the provisions of Section 403(b) of the Internal Revenue Code, and any company including separate accounts, registered pursuant to the Investment Company Act.

(5) Dissenting limited partner — a person who, on the date on which soliciting material is mailed to investors, is a holder of a beneficial interest in a limited partnership that is the subject of a limited partnership rollup transaction, and who casts a vote against the transaction and complies with procedures established by FINRA, except that for purposes of an exchange or tender offer, such person shall file an objection in writing under FINRA rules during the period in which the offer is outstanding. Such objection in writing shall be filed with the party responsible for tabulating the votes or tenders.

(6) Equity interest — when used with respect to a corporation, means common stock and any security convertible into, exchangeable or exercisable for common stock, and, when used with respect to a partnership, means an interest in the capital or profits or losses of the partnership.

(7) Fair market net worth — total assets computed at fair market value less total liabilities.

(8) Limited partner or investor in a limited partnership — the purchaser of an interest in a direct participation program that is a limited partnership who is not involved in the day-to-day management of the limited partnership and bears limited liability.

(9) Limited partnership — an unincorporated association that is a direct participation program organized as a limited partnership whose partners are one or more general partners and one or more limited partners, which conforms to the provisions of the Revised Uniform Limited Partnership Act or the applicable statute that regulates the organization of such partnership.

(10) Limited partnership rollup transaction — a transaction involving the combination or reorganization of one or more limited partnerships, directly or indirectly, in which:

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(A) some or all of the investors in any of such limited partnerships will receive new securities, or securities in another entity, that will be reported under a transaction reporting plan declared effective before January 1, 1991, by the SEC under Section 11A of the Exchange Act.

(B) any of the investors' limited partnership securities are not, as of the date of the filing, reported under a transaction reporting plan declared effective before January 1, 1991, by the SEC under Section 11A of the Exchange Act.

(C) investors in any of the limited partnerships involved in the transaction are subject to a significant adverse change with respect to voting rights, the term of existence of the entity, management compensation, or investment objectives; and

(D) any of such investors are not provided an option to receive or retain a security under substantially the same terms and conditions as the original issue. Notwithstanding the foregoing definition, a "limited partnership rollup transaction" does not include:

(i) a transaction that involves only a limited partnership or partnerships having an operating policy or practice of retaining cash available for distribution and reinvesting proceeds from the sale, financing, or refinancing of assets in accordance with such criteria as the SEC determines appropriate;

(ii) a transaction involving only limited partnerships wherein the interests of the limited partners are repurchased, recalled or exchanged pursuant to the terms of the pre-existing limited partnership agreements for securities in an operating company specifically identified at the time of the formation of the original limited partnership;

(iii) a transaction in which the securities to be issued or exchanged are not required to be and are not registered under the Securities Act;

(iv) a transaction that involves only issuers that are not required to register or report under Section 12 of the Exchange Act, both before and after the transaction;

(v) a transaction, except as the SEC may otherwise provide for by rule for the protection of investors, involving the combination or reorganization of one or more limited partnerships in which a non-affiliated party succeeds to the interests of the general partner or sponsor, if:

a. such action is approved by not less than 66 2/3 percent of the outstanding units of each of the participating limited partnerships; and

b. as a result of the transaction, the existing general partners will receive only compensation to which they are entitled as expressly provided for in the pre-existing partnership agreements; or

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(vi) a transaction, except as the SEC may otherwise provide for by rule for the protection of investors, in which the securities offered to investors are securities of another entity that are reported under a transaction reporting plan declared effective before January 1, 1991, by the SEC under Section 11A of the Exchange Act; if:

a. such other entity was formed, and such class of securities was reported and regularly traded, not less than 12 months before the date on which soliciting material is mailed to investors; and

b. the securities of that entity issued to investors in the transaction do not exceed 20 percent of the total outstanding securities of the entity, exclusive of any securities of such class held by or for the account of the entity or a subsidiary of the entity.

(vii) a transaction involving only entities registered under the Investment Company Act or any Business Development Company as defined in Section 2(a)(48) of that Act.

(11) Management fee — a fee paid to the sponsor, general partner(s), their affiliates, or other persons for management and administration of a direct participation program.

(12) Organization and offering expenses — expenses incurred in preparing a direct participation program for registration and subsequently offering interests in the program to the public, including all forms of compensation paid to underwriters, broker-dealers, or affiliates thereof in connection with the offering of the program.

(13) Participant — the purchaser of an interest in a direct participation program.

(14) Person — any natural person, partnership, corporation, association or other legal entity.

(15) Prospectus — a prospectus as defined by Section 2(10) of the Securities Act, as amended, an offering circular as described in Securities Act Rule 256 or, in the case of an intrastate offering, any document utilized for the purpose of announcing the offer and sale of securities to the public.

(16) Registration statement — a registration statement as defined by Section 2(8) of the Securities Act, as amended, a notification on Form 1-A filed with the SEC pursuant to the provisions of Securities Act Rule 255 and, in the case of an intrastate offering, any document initiating a registration or similar process for an issue of securities which is required to be filed by the laws or regulations of any state.

(17) Solicitation expenses — direct marketing expenses incurred by a member, in connection with a limited partnership rollup transaction such as telephone calls, broker-dealer



fact sheets, members' legal and other fees related to the solicitation, as well as direct solicitation compensation to members.

(18) Sponsor — a person who directly or indirectly provides management services for a direct participation program whether as general partner, pursuant to contract or otherwise.

(19) Transaction costs — costs incurred in connection with a limited partnership rollup transaction, including printing and mailing the proxy, prospectus or other documents; legal fees not related to the solicitation of votes or tenders; financial advisory fees; investment banking fees; appraisal fees; accounting fees; independent committee expenses; travel expenses; and all other fees related to the preparatory work of the transaction, but not including costs that would have otherwise been incurred by the subject limited partnerships in the ordinary course of business or solicitation expenses.

## **(b) Requirements**

### **(1) Application**

No member or person associated with a member shall participate in a public offering of a direct participation program, a limited partnership rollup transaction or, where expressly provided below, a real estate investment trust as defined in Rule 2231(d)(4)("REIT"), except in accordance with this paragraph (b).

### **(2) Suitability**

(A) A member or person associated with a member shall not underwrite or participate in a public offering of a direct participation program unless standards of suitability have been established by the program for participants therein and such standards are fully disclosed in the prospectus and are consistent with the provisions of subparagraph (B).

(B) In recommending to a participant the purchase, sale or exchange of an interest in a direct participation program, a member or person associated with a member shall:

(i) have reasonable grounds to believe, on the basis of information obtained from the participant concerning his investment objectives, other investments, financial situation and needs, and any other information known by the member or associated person, that:

a. the participant is or will be in a financial position appropriate to enable him to realize to a significant extent the benefits described in the prospectus, including the tax benefits where they are a significant aspect of the program;

b. the participant has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity; and

c. the program is otherwise suitable for the participant; and

(ii) maintain in the files of the member documents disclosing the basis upon which the determination of suitability was reached as to each participant.

(C) Notwithstanding the provisions of subparagraphs (A) and (B) hereof, no member shall execute any transaction in direct participation program in a discretionary account without prior written approval of the transaction by the customer.

(D) Subparagraphs (A) and (B), and, only in situations where the member is not affiliated with the direct participation program, subparagraph (C) shall not apply to:

(i) a secondary public offering of or a secondary market transaction in a unit, depositary receipt, or other interest in a direct participation program that is listed on a national securities exchange; or

(ii) an initial public offering of a unit, depositary receipt or other interest in a direct participation program for which an application for listing on a national securities exchange has been approved by such exchange and the applicant makes a good faith representation that it believes such listing on an exchange will occur within a reasonable period of time following the formation of the program.

### **(3) Disclosure**

(A) Prior to participating in a public offering of a direct participation program or REIT, a member or person associated with a member shall have reasonable grounds to believe, based on information made available to him by the sponsor through a prospectus or other materials, that all material facts are adequately and accurately disclosed and provide a basis for evaluating the program.

(B) In determining the adequacy of disclosed facts pursuant to subparagraph (A) hereof, a member or person associated with a member shall obtain information on material facts relating at a minimum to the following, if relevant in view of the nature of the program:

(i) items of compensation;

(ii) physical properties;

(iii) tax aspects;

(iv) financial stability and experience of the sponsor;

(v) the program's conflict and risk factors; and

(vi) appraisals and other pertinent reports.

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(C) For purposes of subparagraphs (A) or (B) hereof, a member or person associated with a member may rely upon the results of an inquiry conducted by another member or members, provided that:

(i) the member or person associated with a member has reasonable grounds to believe that such inquiry was conducted with due care;

(ii) the results of the inquiry were provided to the member or person associated with a member with the consent of the member or members conducting or directing the inquiry; and

(iii) no member that participated in the inquiry is a sponsor of the program or an affiliate of such sponsor.

(D) Prior to executing a purchase transaction in a direct participation program or a REIT, a member or person associated with a member shall inform the prospective participant of all pertinent facts relating to the liquidity and marketability of the program or REIT during the term of the investment. Included in the pertinent facts shall be information regarding whether the sponsor has offered prior programs or REITs in which disclosed in the offering materials was a date or time period at which the program or REIT might be liquidated, and whether the prior program(s) or REIT(s) in fact liquidated on or around that date or during the time period; provided however, this subparagraph (D) shall not apply to an initial or secondary public offering of or a secondary market transaction in a unit, depositary receipt or other interest in a direct participation program that meets the criteria in paragraph (b)(2)(D)(i) or (ii).

#### **(4) Organization and Offering Expenses**

(A) No member or person associated with a member shall underwrite or participate in a public offering of a direct participation program or REIT if the organization and offering expenses are not fair and reasonable, taking into consideration all relevant factors.

(B) In determining the fairness and reasonableness of organization and offering expenses that are deemed to be in connection with or related to the distribution of the public offering for purposes of subparagraph (A) hereof, the arrangements shall be presumed to be unfair and unreasonable if:

(i) organization and offering expenses, as defined in paragraph (b)(4)(C), in which a member or an affiliate of a member is a sponsor, exceed an amount that equals fifteen percent of the gross proceeds of the offering;

(ii) the total amount of all items of compensation from whatever source, including compensation paid from offering proceeds and in the form of "trail

commissions, payable to underwriters, broker-dealers, or affiliates thereof exceeds an amount that equals ten percent of the gross proceeds of the offering (excluding securities purchased through the reinvestment of dividends);

(iii) any compensation in connection with an offering is to be paid to underwriters, broker-dealers, or affiliates thereof out of the proceeds of the offering prior to the release of such proceeds from escrow, provided, however, that any such payment from sources other than proceeds of the offering shall be made only on the basis of bona fide transactions;

(iv) commissions or other compensation are to be paid or awarded either directly or indirectly, to any person engaged by a potential investor for investment advice as an inducement to such advisor to advise the purchaser of interests in a particular program or REIT, unless such person is a registered broker-dealer or a person associated with such a broker-dealer;

(v) the program or REIT provides for compensation of an indeterminate nature to be paid to members or persons associated with members for sales of the program or REIT, or for services of any kind rendered in connection with or related to the distribution thereof, including, but not necessarily limited to, the following: a percentage of the management fee, a profit sharing arrangement, brokerage commissions, an over-riding royalty interest, a net profits interest, a percentage of revenues, a reversionary interest, a working interest, a security or right to acquire a security having an indeterminate value, or other similar incentive items;

(vi) the program or REIT charges a sales load or commission on securities that are purchased through the reinvestment of dividends, unless the registration statement registering the securities under the Securities Act became effective prior to August 6, 2008; or

(vii) the member has received reimbursement for due diligence expenses that are not included in a detailed and itemized invoice, unless the amount of the reimbursement is included in the calculation of underwriting compensation as a non-accountable expense allowance, which when aggregated with all other such non-accountable expenses, does not exceed three percent of offering proceeds.

(C) The organization and offering expenses subject to the limitations in paragraph (b)(4)(B)(i) above include the following:

(i) issuer expenses that are reimbursed or paid for with offering proceeds, including overhead expenses, which issuer expenses include, but are not limited to, expenses for:

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a. assembling, printing and mailing offering materials, processing subscription agreements, generating advertising and sales materials;

b. legal and accounting services provided to the sponsor or issuer;

c. salaries and non-transaction-based compensation paid to employees or agents of the sponsor or issuer for performing services for the issuer;

d. transfer agents, escrow holders depositories, engineers and other experts; and

e. registration and qualification of securities under federal and state law, including taxes and fees and FINRA fees;

(ii) underwriting compensation as defined in Rule 5110(j)(22) including payments:

a. to any wholesaling or retailing firm that is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities;

b. to any registered representative of a member who receives transaction-based compensation in connection with the offering, except to the extent that such compensation has been included in a. above;

c. to any registered representative who is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities, except:

1. to the extent that such compensation has been included in a. above;

2. for a registered representative whose functions in connection with the offering are solely and exclusively clerical or ministerial; and

3. for a registered representative whose sales activities are *de minimis* and incidental to his or her clerical or ministerial job functions; or

d. for training and education meetings, legal services provided to a member in connection with the offering, advertising and sales material generated by the member and contributions to conferences and meetings held by non-affiliated members for their registered representatives.

(iii) due diligence expenses incurred when a member affirmatively discharges its responsibilities to ensure that all material facts pertaining to a program or REIT are adequately and accurately disclosed in the offering document.

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(D) Notwithstanding paragraphs (b)(4)(C)(ii)b. and c. above, for every program or REIT filed with the Corporate Financing Department (the "Department") for review, the Department shall, based upon the information provided, make a determination as to whether some portion of a registered representative's non-transaction-based compensation should not be deemed to be underwriting compensation if the registered representative is either:

(i) a dual employee of a member and the sponsor, issuer or other affiliate with respect to a program or REIT with ten or fewer registered representatives engaged in wholesaling, in which instance the Department may make such determination with respect to the ten or fewer registered representatives engaged in wholesaling; or

(ii) a dual employee of a member and the sponsor, issuer or other affiliate who is one of the top ten highest paid executives based on non-transaction-based compensation in any program or REIT.

(E) All items of compensation paid by the program or REIT directly or indirectly from whatever source to underwriters, broker-dealers, or affiliates thereof, including, but not limited to, sales commissions, wholesaling fees, due diligence expenses, other underwriter's expenses, underwriter's counsel's fees, securities or rights to acquire securities, rights of first refusal, consulting fees, finder's fees, investor relations fees, and any other items of compensation for services of any kind or description, which are deemed to be in connection with or related to the public offering, shall be taken into consideration in computing the amount of compensation for purposes of determining compliance with the provisions of subparagraphs (A) and (B).

(F) The determination of whether compensation paid to underwriters, broker-dealers, or affiliates thereof is in connection with or related to a public offering, for purposes of this subparagraph (4), shall be made on the basis of such factors as the timing of the transaction, the consideration rendered, the investment risk, and the role of the member or affiliate in the organization, management and direction of the enterprise in which the sponsor is involved.

(i) An affiliate of a member which acts or proposes to act as a general partner, associate general partner, or other sponsor of a program or REIT shall be presumed to be bearing investment risk for purposes of this paragraph (b) if the affiliate:

a. is subject to potential liability as a general partner to the same extent as any other general partner;

b. is not indemnified against potential liability as a general partner to any greater or different extent than any other general partner for its actions or those of any other general partner;

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c. has a net worth equal to at least five percent of the net proceeds of the public offering or \$1.0 million, whichever is less; provided, however, that the computation of the net worth shall not include an interest in the program offered but may include net worth applied to satisfy the requirements of this paragraph (b) with respect to other programs or REITs; and

d. agrees to maintain net worth as required by subparagraph c. above under its control until the earlier of the removal or withdrawal of the affiliate as a general partner, associate general partner, or other sponsor, or the dissolution of the program or REIT.

(ii) For purposes of determining the factors to be utilized in computing compensation derived from securities received in connection with a public offering, the guidelines set forth in Rule 5110 shall govern to the extent applicable.

(G) Subject to the limitations on direct and indirect non-cash compensation provided under subparagraph (C), no member shall accept any cash compensation unless all of the following conditions are satisfied:

(i) all compensation is paid directly to the member in cash and the distribution, if any, of all compensation to the member's associated persons is controlled solely by the member;

(ii) the value of all compensation to be paid in connection with an offering is included as compensation to be received in connection with the offering for purposes of subparagraph (B);

(iii) arrangements relating to the proposed payment of all compensation are disclosed in the prospectus or similar offering document;

(iv) the value of all compensation paid in connection with an offering is reflected on the books and records of the recipient member as compensation received in connection with the offering; and

(v) no compensation paid in connection with an offering is directly or indirectly related to any non-cash compensation or sales incentive items provided by the member to its associated persons.

## **(5) Valuation for Customer Account Statements**

A member shall not participate in a public offering of the securities of a direct participation program (DPP) that is not subject to the requirements of the Investment Company Act of 1940 or of a REIT unless the issuer of the DPP or REIT has agreed to disclose:

(A) a per share estimated value of the DPP or REIT security, developed in a manner reasonably designed to ensure it is reliable, in the DPP or REIT periodic reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act;

(B) an explanation of the method by which the per share estimated value was developed;

(C) the date of the valuation; and

(D) in a periodic or current report filed pursuant to Section 13(a) or 15(d) of the Exchange Act within 150 days following the second anniversary of breaking escrow and in each annual report thereafter, a per share estimated value:

(i) based on valuations of the assets and liabilities of the DPP or REIT performed at least annually, by, or with the material assistance or confirmation of, a third-party valuation expert or service;

(ii) derived from a methodology that conforms to standard industry practice; and

(iii) accompanied by a written opinion or report by the issuer, delivered at least annually, that explains the scope of the review, the methodology used to develop the valuation or valuations, and the basis for the value or values reported.

## **(6) Participation in Rollups**

(A) No member or person associated with a member shall participate in the solicitation of votes or tenders from limited partners in connection with a limited partnership rollup transaction, irrespective of the form of the resulting entity (i.e., a partnership, real estate investment trust or corporation), unless any compensation received by the member:

(i) is payable and equal in amount regardless of whether the limited partner votes affirmatively or negatively in the proposed limited partnership rollup transaction;

(ii) in the aggregate, does not exceed 2% of the exchange value of the newly created securities; and

(iii) is paid regardless of whether the limited partners reject the proposed limited partnership rollup transaction.

(B) No member or person associated with a member shall participate in the solicitation of votes or tenders from limited partners in connection with a limited partnership rollup transaction unless the general partner(s) or sponsor(s) proposing the limited partnership rollup transaction agrees to pay all solicitation expenses related to the limited



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partnership rollup transaction, including all preparatory work related thereto, in the event the limited partnership rollup transaction is rejected.

(C) No member or person associated with a member shall participate in any capacity in a limited partnership rollup transaction if the transaction is unfair or unreasonable.

(i) A limited partnership rollup transaction will be presumed not to be unfair or unreasonable if the limited partnership rollup transaction provides for the right of dissenting limited partners:

a. to receive compensation for their limited partnership units based on an appraisal of the limited partnership assets performed by an independent appraiser unaffiliated with the sponsor or general partner of the program that values the assets as if sold in an orderly manner in a reasonable period of time, plus or minus other balance sheet items, and less the cost of sale or refinancing and in a manner consistent with the appropriate industry practice. Compensation to dissenting limited partners of limited partnership rollup transactions may be cash, secured debt instruments, unsecured debt instruments, or freely tradeable securities; provided, however, that:

1. limited partnership rollup transactions which utilize debt instruments as compensation must provide for a trustee and an indenture to protect the rights of the debt holders and provide a rate of interest equal to at least 120% of the applicable federal rate as determined in accordance with Section 1274 of the Internal Revenue Code of 1986;

2. limited partnership rollup transactions which utilize unsecured debt instruments as compensation, in addition to the requirements of subparagraph 1., must limit total leverage to 70% of the appraised value of the assets;

3. all debt securities must have a term no greater than 8 years and provide for prepayment with 80% of the net proceeds of any sale or refinancing of the assets previously owned by the partnership entitles subject to the limited partnership rollup transaction or any part thereof; and

4. freely tradeable securities used as compensation to dissenting limited partners must be previously listed on a national securities exchange prior to the limited partnership rollup transaction, and the number of securities to be received in return for limited partnership interests must be determined in relation to the average last sale price of the freely tradeable securities in the 20-day period following the date of

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the meeting at which the vote on the limited partnership rollup transaction occurs. If the issuer of the freely tradeable securities is affiliated with the sponsor or general partner, newly issued securities to be used as compensation to dissenting limited partners shall not represent more than 20 percent of the issued and outstanding shares of that class of securities after giving effect to the issuance. For purposes of the preceding sentence, a sponsor or general partner is "affiliated" with the issuer of the freely tradeable securities if the sponsor or general partner receives any material compensation from the issuer or its affiliates in conjunction with the limited partnership rollup transaction or the purchase of the general partner's interest; provided, however, that nothing herein shall restrict the ability of a sponsor or general partner to receive any payment for its equity interests and compensation as otherwise provided by this subparagraph.

b. to receive or retain a security with substantially the same terms and conditions as the security originally held. Securities received or retained will be considered to have the same terms and conditions as the security originally held if:

1. there is no material adverse change to dissenting limited partners' rights with respect to the business plan or the investment, distribution and liquidation policies of the limited partnership; and

2. the dissenting limited partners receive substantially the same rights, preferences and priorities as they had pursuant to the security originally held; or

c. to receive other comparable rights including, but not limited to:

1. approval of the limited partnership rollup transaction by 75% of the outstanding units of each of the individual participating limited partnerships and the exclusion of any individual limited partnership from the limited partnership rollup transaction which fails to reach the 75% threshold. The third-party appointed to tabulate votes and dissents pursuant to subparagraph (C)(ii)b.4. hereof shall submit the results of such tabulation to FINRA;

2. review of the limited partnership rollup transaction by an independent committee of persons not affiliated with the general partner(s) or sponsor. Whenever utilized, the independent committee:

A. shall be approved by a majority of the outstanding securities of each of the participating partnerships;

B. shall have access to the books and records of the partnerships;

C. shall prepare a report to the limited partners subject to the limited partnership rollup transaction that presents its findings and recommendations, including any minority views;

D. shall have the authority to negotiate the proposed transaction with the general partner or sponsor on behalf of the limited partners, but not the authority to approve the transaction on behalf of the limited partners;

E. shall not deliberate for a period longer than 60 days, although extensions will be permitted if unanimously agreed upon by the members of the independent committee or if approved by FINRA;

F. may be compensated and reimbursed by the limited partnerships subject to the limited partnership rollup transaction and shall have the ability to retain independent counsel and financial advisors to represent all limited partners at the limited partnerships' expense provided the fees are reasonable; and

G. shall be entitled to indemnification to the maximum extent permitted by law from the limited partnerships subject to the limited partnership rollup transaction from claims, causes of action or lawsuits related to any action or decision made in furtherance of their responsibilities; provided, however, that general partners or sponsors may also agree to indemnify the independent committee; or

3. any other comparable rights for dissenting limited partners proposed by general partners or sponsors, provided, however, that the general partner(s) or sponsor demonstrates to the satisfaction of FINRA or, if FINRA determines appropriate, to the satisfaction of an independent committee, that the rights proposed are comparable.

(ii) Regardless of whether a limited partnership rollup transaction is in compliance with subparagraph (C)(i), a limited partnership rollup transaction will be presumed to be unfair and unreasonable:

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a. if the general partner(s):

1. converts an equity interest in any limited partnership(s) subject to a limited partnership rollup transaction for which consideration was not paid and which was not otherwise provided for in the limited partnership agreement and disclosed to limited partners, into a voting interest in the new entity (provided, however, an interest originally obtained in order to comply with the provisions of Internal Revenue Service Revenue Proclamation 89-12 may be converted);

2. fails to follow the valuation provisions, if any, in the limited partnership agreements of the subject limited partnerships when valuing their limited partnership interests; or

3. utilizes a future value of their equity interest in the limited partnership rather than the current value of their equity interest, as determined by an appraisal conducted in a manner consistent with subparagraph (C)(i)a., when determining their interest in the new entity;

b. as to voting rights, if:

1. the voting rights in the entity resulting from a limited partnership rollup transaction do not generally follow the original voting rights of the limited partnerships participating in the limited partnership rollup transaction; provided, however, that changes to voting rights may be effected if FINRA determines that such changes are not unfair or if the changes are approved by an independent committee;

2. a majority of the interests in an entity resulting from a limited partnership rollup transaction may not, without concurrence by the sponsor, general partner(s), board of directors, trustee, or similar governing entity, depending on the form of entity and to the extent not inconsistent with applicable state law, vote to:

A. amend the limited partnership agreement, articles of incorporation or by-laws, or indenture;

B. dissolve the entity;

C. remove the general partner, board of directors, trustee or similar governing entity, and elect a new general partner, board of directors, trustee or similar governing entity; or

D. approve or disapprove the sale of substantially all of the assets of the entity;

3. the general partner(s) or sponsor(s) proposing a limited partnership rollup transaction do not provide each limited partner with a document which instructs the limited partner on the proper procedure for voting against or dissenting from the transaction; or

4. the general partner(s) or sponsor(s) does not utilize an independent third party to receive and tabulate all votes and dissents in connection with the limited partnership rollup transaction, and require that the third party make the tabulation available to the general partner and any limited partner upon request at any time during and after voting occurs;

c. as to transaction costs, if:

1. transaction costs of a rejected limited partnership rollup transaction are not apportioned between general and limited partners of the subject limited partnerships according to the final vote on the proposed transaction as follows:

A. the general partner(s) or sponsor(s) bear all transaction costs in proportion to the total number of abstentions and votes to reject the limited partnership rollup transaction; and

B. limited partners bear transaction costs in proportion to the number of votes to approve the limited partnership rollup transaction; or

2. individual limited partnerships that do not approve a limited partnership rollup transaction are required to pay any of the transaction costs, and the general partner or sponsor is not required to pay the transaction costs on behalf of the non-approving limited partnerships, in a limited partnership rollup transaction in which one or more limited partnerships determines not to approve the transaction, but where the transaction is consummated with respect to one or more approving limited partnerships; or

d. as to fees of general partners, if:

1. general partners are not prevented from receiving both unearned management fees discounted to a present value (if such fees were not

previously provided for in the limited partnership agreement and disclosed to limited partners) and new asset-based fees;

2. property management fees and other general partner fees are inappropriate, unreasonable and more than, or not competitive with, what would be paid to third parties for performing similar services; or

3. changes in fees which are substantial and adverse to limited partners are not approved by an independent committee according to the facts and circumstances of each transaction.

### **(c) Non-Cash Compensation**

#### **(1) Definitions**

The terms "compensation," "non-cash compensation" and "offeror" for the purposes of this paragraph (c) shall have the following meanings:

(A) "Compensation" shall mean cash compensation and non-cash compensation.

(B) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of direct participation securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, sponsor, an adviser to an issuer or sponsor, an underwriter and any affiliated person of such entities.

#### **(2) Restriction on Non-Cash Compensation**

In connection with the sale and distribution of direct participation program or REIT securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided below. Non-cash compensation arrangements must be consistent with the applicable requirements of SEA Rule 15l-1 ("Regulation Best Interest") and are limited to the following:

(A) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors<sup>1</sup> and are not conditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (c)(2)(D);

(ii) the location is appropriate to the purpose of the meeting, which shall mean a United States office of the offeror or the member holding the meeting, or a facility located in the vicinity of such office, or a United States regional location with respect to meetings of associated persons who work within that region or, with respect to meetings with direct participation programs or REITs, a United States location at which a significant or representative asset of the program or REIT is located;

(iii) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(iv) the payment or reimbursement by the offeror is not conditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (c)(2)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (c)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by paragraphs (c)(2)(C) through (E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with paragraph (c)(2)(C) through (E).

#### **(d) Exemptions**

Pursuant to the Rule 9600 Series, FINRA may exempt a member or person associated with a member from the provisions of this Rule for good cause shown.

<sup>1</sup> The current annual amount fixed by the Board of Governors is \$100.

Amended by SR-FINRA-2019-012. eff. Sept. 16, 2020.

Amended by SR-FINRA-2020-007 eff. June 30, 2020.

Amended by SR-FINRA-2019-009 eff. May 8, 2019.

Amended by SR-FINRA-2014-006 eff. April 11, 2016.

Amended by SR-FINRA-2009-046 eff. Aug. 17, 2009.

Amended by SR-FINRA-2009-016 eff. Aug. 17, 2009.

Amended by SR-NASD-2005-114 eff. Aug. 6, 2008.

Amended by SR-NASD-2005-087 eff. Aug. 1, 2006.

Amended by SR-NASD-2003-68 eff. April 7, 2003.

Amended by SR-NASD-00-13 eff. April 16, 2001.

Amended by SR-NASD-97-28 eff. Aug. 7, 1997.

Amended by SR-NASD-95-21 eff. July 11, 1995.

Amended by SR-NASD-95-19 eff. July 3, 1995.

Amended by SR-NASD-93-03 eff. Nov. 1, 1994.

Amended by SR-NASD-93-48 eff. Mar. 8, 1994.

Amended by SR-NASD-93-29 eff. June 23, 1993.

Amended by SR-NASD-91-24 eff. Aug. 19, 1991.

Amended by SR-NASD-84-10 eff. Feb. 1, 1989.

Amended by SR-NASD-86-22 eff. Jan. 1, 1989.

Amended by SR-NASD-86-21 eff. Sept. 15, 1986.

Amended by SR-NASD-85-26 eff. Nov. 5, 1985.

Amended by SR-NASD-84-2 eff. July 3, 1984.

Amended by SR-NASD-XX-XX eff. Jan. 17, 1984.

Amended by SR-NASD-82-21 eff. Nov. 8, 1982.

Amended SR-NASD-81-19 eff. Sept. 16, 1982.

Adopted by SR-NASD-77-8 eff. July 14, 1980.

**Selected Notices:** 73-50, 77-03, 78-12, 81-34, 82-14, 82-50, 82-51, 82-52, 83-13, 83-49, 84-28, 84-64, 85-17, 85-29, 86-66, 86-81, 88-88, 89-16, 91-56, 91-78, 93-15, 93-44, 94-24, 94-70, 95-63, 95-64, 03-53, 08-35, 09-33, 15-02, 20-10, 20-18.



# 2320. Variable Contracts of an Insurance Company

The Rule

Notices

## (a) Application

This Rule shall apply exclusively (and in lieu of Rule 2341) to the activities of members in connection with variable contracts, to the extent such activities are subject to regulation under the federal securities laws.

## (b) Definitions

(1) The term "purchase payment" as used throughout this Rule shall mean the consideration paid at the time of each purchase or installment for or under the variable contract.

(2) The term "variable contracts" shall mean contracts providing for benefits or values which may vary according to the investment experience of any separate or segregated account or accounts maintained by an insurance company.

(3) The terms "affiliated member," "compensation," "cash compensation," "non-cash compensation" and "offeror" as used in paragraph (g) of this Rule shall have the following meanings:

(A) "Affiliated Member" shall mean a member which, directly or indirectly, controls, is controlled by, or is under common control with a non-member company.

(B) "Compensation" shall mean cash compensation and non-cash compensation.

(C) "Cash compensation" shall mean any discount, concession, fee, service fee, commission, asset based sales charge, loan, override, or cash employee benefit received in connection with the sale and distribution of variable contracts.

(D) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of variable contracts that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(E) "Offeror" shall mean an insurance company, a separate account of an insurance company, an investment company that funds a separate account, any adviser to a separate account of an insurance company or an investment company that funds a

**(c) Receipt of Payment**

No member shall participate in the offering or in the sale of a variable contract on any basis other than at a value to be determined following receipt of payment therefor in accordance with the provisions of the contract, and, if applicable, the prospectus, the Investment Company Act and applicable rules thereunder. Payments need not be considered as received until the contract application has been accepted by the insurance company, except that by mutual agreement it may be considered to have been received for the risk of the purchaser when actually received.

**(d) Transmittal**

Every member who receives applications and/or purchase payments for variable contracts shall transmit promptly to the issuer all such applications and at least that portion of the purchase payment required to be credited to the contract.

**(e) Selling Agreements**

No member who is a principal underwriter as defined in the Investment Company Act may sell variable contracts through another broker-dealer unless (1) such broker-dealer is a member, and (2) there is a sales agreement in effect between the parties. Such sales agreement must provide that the sales commission be returned to the issuing insurance company if the variable contract is tendered for redemption within seven business days after acceptance of the contract application.

**(f) Redemption**

No member shall participate in the offering or in the sale of a variable contract unless the insurance company, upon receipt of a request in proper form for partial or total redemption in accordance with the provisions of the contract undertakes to make prompt payment of the amounts requested and payable under the contract in accordance with the terms thereof, and, if applicable, the prospectus, the Investment Company Act and applicable rules thereunder.

**(g) Member Compensation**

In connection with the sale and distribution of variable contracts:

(1) Except as described below, no associated person of a member shall accept any compensation from anyone other than the member with which the person is associated. This requirement will not prohibit arrangements where a non-member company pays compensation directly to associated persons of the member, provided that:

(A) the arrangement is agreed to by the member;

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(B) the member relies on an appropriate rule, regulation, interpretive release, interpretive letter, or "no-action" letter issued by the SEC that applies to the specific fact situation of the arrangement;

(C) the receipt by associated persons of such compensation is treated as compensation received by the member for purposes of the FINRA rules; and

(D) the record keeping requirement in paragraph (g)(3) is satisfied.

(2) No member or person associated with a member shall accept any compensation from an offeror which is in the form of securities of any kind.

(3) Except for items as described in paragraphs (g)(4)(A) and (B), a member shall maintain records of all compensation received by the member or its associated persons from offerors. The records shall include the names of the offerors, the names of the associated persons, the amount of cash, and the nature and value of non-cash compensation received.

(4) No member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided below. Notwithstanding the provisions of paragraph (g)(1), the following non-cash compensation arrangements are permitted provided that they are consistent with the applicable requirements of SEA Rule 15l-1 ("Regulation Best Interest"):

(A) Gifts that do not exceed an annual amount per person fixed periodically by FINRA<sup>1</sup> and are not preconditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) the record keeping requirement in paragraph (g)(3) is satisfied;

(ii) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not preconditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (g)(4)(D);

(iii) the location is appropriate to the purpose of the meeting, which shall mean an office of the offeror or the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iv) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(v) the payment or reimbursement by the offeror is not preconditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (g)(4)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member, provided that:

(i) the member's or non-member's non-cash compensation arrangement, if it includes variable contract securities, is based on the total production of associated persons with respect to all variable contract securities distributed by the member;

(ii) the non-cash compensation arrangement requires that the credit received for each variable contract security is equally weighted;

(iii) no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(iv) the record keeping requirement in paragraph (g)(3) is satisfied.

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (g)(4)(D).

<sup>1</sup> The current annual amount fixed by FINRA is \$100.

Amended by SR-FINRA-2020-007 eff. June 30, 2020.

Amended by SR-FINRA-2016-026 eff. July 9, 2016.

Amended by SR-FINRA-2009-023 eff. Oct. 19, 2009.

Amended by SR-NASD-98-14 eff. April 1, 2000.

Amended by SR-NASD-97-35 eff. Jan. 1, 1999.

Amended eff. May 1, 1976.

Added eff. Feb. 8, 1971.

**Selected Notices:** 75-68, 88-17, 91-25, 91-68, 94-67, 95-56, 96-52, 96-86, 97-27, 97-48, 97-50, 98-75, 99-35, 99-55, 99-103, 00-44, 01-63, 09-50, 20-18.

# 2330. Members' Responsibilities Regarding Deferred Variable Annuities

The Rule

Notices

## (a) General Considerations

### (1) Application

This Rule applies to recommended purchases and exchanges of deferred variable annuities and recommended initial subaccount allocations. This Rule does not apply to reallocations among subaccounts made or to funds paid after the initial purchase or exchange of a deferred variable annuity. This Rule also does not apply to deferred variable annuity transactions made in connection with any tax-qualified, employer-sponsored retirement or benefit plan that either is defined as a "qualified plan" under Section 3(a)(12)(C) of the Exchange Act or meets the requirements of Internal Revenue Code Sections 403(b), 457(b), or 457(f), unless, in the case of any such plan, a member or person associated with a member makes recommendations to an individual plan participant regarding a deferred variable annuity, in which case the Rule would apply as to the individual plan participant to whom the member or person associated with the member makes such recommendations.

### (2) Creation, Storage, and Transmission of Documents

For purposes of this Rule, documents may be created, stored, and transmitted in electronic or paper form, and signatures may be evidenced in electronic or other written form.

### (3) Definitions

For purposes of this Rule, the term "registered principal" shall mean a person registered as a General Securities Sales Supervisor (Series 9/10), a General Securities Principal (Series 24) or an Investment Company Products/Variable Contracts Principal (Series 26), as applicable.

## (b) Recommendation Requirements

(1) No member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member has a reasonable basis to believe

(A) that the transaction is suitable in accordance with Rule 2111 and, in particular, that there is a reasonable basis to believe that

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(i) the customer has been informed, in general terms, of various features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty if customers sell or redeem deferred variable annuities before reaching the age of 59½; mortality and expense fees; investment advisory fees; potential charges for and features of riders; the insurance and investment components of deferred variable annuities; and market risk;

(ii) the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit; and

(iii) the particular deferred variable annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and riders and similar product enhancements, if any, are suitable (and, in the case of an exchange, the transaction as a whole also is suitable) for the particular customer based on the information required by paragraph (b)(2) of this Rule; and

(B) in the case of an exchange of a deferred variable annuity, the exchange also is consistent with the suitability determination required by paragraph (b)(1)(A) of this Rule, taking into consideration whether

(i) the customer would incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living, or other contractual benefits), or be subject to increased fees or charges (such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements);

(ii) the customer would benefit from product enhancements and improvements; and

(iii) the customer has had another deferred variable annuity exchange within the preceding 36 months.

The determinations required by this paragraph shall be documented and signed by the associated person recommending the transaction.

(2) Prior to recommending the purchase or exchange of a deferred variable annuity, a member or person associated with a member shall make reasonable efforts to obtain, at a minimum, information concerning the customer's age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the deferred variable annuity, investment time horizon, existing assets (including investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, tax status, and such other information

used or considered to be reasonable by the member or person associated with the member in making recommendations to customers.

(3) Promptly after receiving information necessary to prepare a complete and correct application package for a deferred variable annuity, a person associated with a member who recommends the deferred variable annuity shall transmit the complete and correct application package to an office of supervisory jurisdiction of the member.

### **(c) Principal Review and Approval**

Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after an office of supervisory jurisdiction of the member receives a complete and correct application package, a registered principal shall review and determine whether he or she approves of the recommended purchase or exchange of the deferred variable annuity.

A registered principal shall approve the recommended transaction only if he or she has determined that there is a reasonable basis to believe that the transaction would be suitable based on the factors delineated in paragraph (b) of this Rule.

The determinations required by this paragraph shall be documented and signed by the registered principal who reviewed and then approved or rejected the transaction.

### **(d) Supervisory Procedures**

In addition to the general supervisory and recordkeeping requirements of Rules 3110, 3120, 3130, 3150, and 4510 Series, a member must establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the standards set forth in this Rule. The member also must (1) implement surveillance procedures to determine if any of the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable FINRA rules, or the federal securities laws ("inappropriate exchanges") and (2) have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges.

### **(e) Training**

Members shall develop and document specific training policies or programs reasonably designed to ensure that associated persons who effect and registered principals who review transactions in deferred variable annuities comply with the requirements of this Rule and that they understand the material features of deferred variable annuities, including those described in paragraph (b)(1)(A)(i) of this Rule.

• • • **Supplementary Material:**                     

**.01 Depositing of Funds by Members Prior to Principal Approval.** Under Rule 2330, a member that is permitted to maintain customer funds under SEA Rules 15c3-1 and 15c3-3 may, prior to the member's principal approval of the deferred variable annuity, deposit and maintain customer funds for a deferred variable annuity in an account that meets the requirements of SEA Rule 15c3-3.

**.02 Treatment of Lump-Sum Payment for Purchases of Different Products.** If a customer provides a member that is permitted to hold customer funds with a lump sum or single check made payable to the member (as opposed to being made payable to the insurance company) and requests that a portion of the funds be applied to the purchase of a deferred variable annuity and the rest of the funds be applied to other types of products, Rule 2330 would not prohibit the member from promptly applying those portions designated for purchasing products other than a deferred variable annuity to such use. A member that is not permitted to hold customer funds can comply with such requests only through its clearing firm that will maintain customer funds for the intended deferred variable annuity purchase in an account that meets the requirements of SEA Rule 15c3-3. In such circumstances, the checks would need to be made payable to the clearing firm.

**.03 Forwarding of Checks/Funds to Insurer Prior to Principal Approval.** Rule 2330 does not prohibit a member from forwarding a check made payable to the insurance company or, if the member is fully subject to SEA Rule 15c3-3, transferring funds for the purchase of a deferred variable annuity to the insurance company prior to the member's principal approval of the deferred variable annuity, as long as the member fulfills the following requirements: (a) the member must disclose to the customer the proposed transfer or series of transfers of the funds and (b) the member must enter into a written agreement with the insurance company under which the insurance company agrees that, until such time as it is notified of the member's principal approval and is provided with the application or is notified of the member's principal rejection, it will (1) segregate the member's customers' funds in a bank in an account equivalent to the deposit of those funds by a member into a "Special Account for the Exclusive Benefit of Customers" (set up as described in SEA Rules 15c3-3(k)(2)(i) and 15c3-3(f)) to ensure that the customers' funds will not be subject to any right, charge, security interest, lien, or claim of any kind in favor of the member, insurance company, or bank where the insurance company deposits such funds or any creditor thereof or person claiming through them and hold those funds either as cash or any instrument that a broker or dealer may deposit in its Special Reserve Account for the Exclusive Benefit of Customers, (2) not issue the variable annuity contract prior to the member's principal approval, and (3) promptly return the funds to each customer at the customer's request prior to the member's principal approval or upon the member's rejection of the application.

**.04 Forwarding of Checks/Funds to IRA Custodian Prior to Principal Approval.** A member is not prohibited from forwarding a check provided by the customer for the purpose of purchasing a deferred variable annuity and made payable to an IRA custodian for the benefit of the customer (or, if the member is fully subject to SEA Rule 15c3-3, funds) to the IRA custodian prior to the member's principal approval of the deferred variable annuity transaction, as long as the member enters into a



written agreement with the IRA custodian under which the IRA custodian agrees (a) to forward the funds to the insurance company to complete the purchase of the deferred variable annuity contract only after it has been informed that the member's principal has approved the transaction and (b), if the principal rejects the transaction, to inform the customer, seek immediate instructions from the customer regarding alternative disposition of the funds (e.g., asking whether the customer wants to transfer the funds to another IRA custodian, purchase a different investment, or provide other instructions), and promptly implement the customer's instructions.

**.05 Gathering of Information Regarding Customer Exchanges.** Rule 2330 requires that the member or person associated with a member consider whether the customer has had another deferred variable annuity exchange within the preceding 36 months. Under this provision, a member or person associated with a member must determine whether the customer has had such an exchange at the member and must make reasonable efforts to ascertain whether the customer has had an exchange at any other broker-dealer within the preceding 36 months. An inquiry to the customer as to whether the customer has had an exchange at another broker-dealer within 36 months would constitute a "reasonable effort" in this context. Members shall document in writing both the nature of the inquiry and the response from the customer.

**.06 Sharing of Office Space and/or Employees.** Rule 2330 requires principal review and approval "[p]rior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing...." In circumstances where an insurance company and its affiliated broker-dealer share office space and/or employees who carry out both the principal review and the issuance process, FINRA will consider the application "transmitted" to the insurance company only when the broker-dealer's principal, acting as such, has approved the transaction, provided that the affiliated broker-dealer and the insurance company have agreed that the insurance company will not issue the contract prior to principal approval by the broker-dealer.

**.07 Sharing of Information.** Rule 2330 does not prohibit using the information required for principal review and approval in the issuance process, provided that the broker-dealer and the insurance company have agreed that the insurance company will not issue the contract prior to principal approval by the broker-dealer. For instance, the rule does not prohibit a broker-dealer from inputting information used as part of its suitability review into a shared database (irrespective of the media used for that database, i.e., paper or electronic) that the insurance company uses for the issuance process, provided that the broker-dealer and the insurance company have agreed that the insurance company will not issue the contract prior to principal approval by the broker-dealer.

Amended by SR-FINRA-2014-045 eff. Dec. 1, 2014.

Amended by SR-FINRA-2012-027 eff. July 9, 2012.

Amended by SR-FINRA-2011-065 eff. Dec. 5, 2011.

Amended by SR-FINRA-2009-083 eff. Feb. 8, 2010.

Amended by SR-FINRA-2008-019 eff. Feb. 8, 2010.

Amended by SR-FINRA-2008-015 eff. April 17, 2008.

Adopted by SR-NASD-2004-183 eff. May 5, 2008.

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**Selected Notices:** 07-53, 09-32, 09-72.

# 2341. Investment Company Securities

The Rule

Notices

This version is valid from Jun 30, 2020 through May 27, 2024.

Amendments have been announced but are not yet effective. To view other versions open the versions tab on the right.

## (a) Application

This Rule shall apply exclusively to the activities of members in connection with the securities of companies registered under the Investment Company Act; provided however, that Rule 2320 shall apply, in lieu of this Rule, to members' activities in connection with "variable contracts" as defined therein.

## (b) Definitions

(1) The terms "affiliated member," "compensation," "cash compensation," "non-cash compensation" and "offeror" as used in paragraph (l) of this Rule shall have the following meanings:

(A) "Affiliated Member" shall mean a member which, directly or indirectly, controls, is controlled by, or is under common control with a non-member company.

(B) "Compensation" shall mean cash compensation and non-cash compensation.

(C) "Cash compensation" shall mean any discount, concession, fee, service fee, commission, asset-based sales charge, loan, override or cash employee benefit received in connection with the sale and distribution of investment company securities.

(D) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of investment company securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(E) "Offeror" shall mean an investment company, an adviser to an investment company, a fund administrator, an underwriter and any affiliated person (as defined in Section 2(a)(3) of the Investment Company Act) of such entities.

(2) "Brokerage commissions," as used in paragraph (k), shall not be limited to commissions on agency transactions but shall include underwriting discounts or concessions and fees paid to members in connection with tender offers.

(3) "Covered account," as used in paragraph (k), shall mean (A) any other investment company or other account managed by the investment adviser of such investment company, or (B) any other account from which brokerage commissions are received or expected as a result of the request or direction of any principal underwriter of such investment company or of any affiliated person (as defined in the Investment Company Act) of such investment company or of such underwriter, or of any affiliated person of an affiliated person of such investment company.

(4) "Person" shall mean "person" as defined in the Investment Company Act.

(5) "Prime rate," as used in paragraph (d), shall mean the most preferential interest rate on corporate loans at large U.S. money center commercial banks.

(6) "Public offering price" shall mean a public offering price as set forth in the prospectus of the issuing company.

(7) "Rights of accumulation" as used in paragraph (d), shall mean a scale of reducing sales charges in which the sales charge applicable to the securities being purchased is based upon the aggregate quantity of securities previously purchased or acquired and then owned plus the securities being purchased. The quantity of securities owned shall be based upon:

(A) The current value of such securities (measured by either net asset value or maximum offering price); or

(B) Total purchases of such securities at actual offering prices; or

(C) The higher of the current value or the total purchases of such securities.

The quantity of securities owned may also include redeemable securities of other registered investment companies having the same principal underwriter.

(8) "Sales charge" and "sales charges," as used in paragraph (d), shall mean all charges or fees that are paid to finance sales or sales promotion expenses, including front-end, deferred and asset-based sales charges, excluding charges and fees for ministerial, recordkeeping or administrative activities and investment management fees. For purposes of this Rule, members may rely on the sales-related fees and charges disclosed in the prospectus of an investment company.

(A) An "asset-based sales charge" is a sales charge that is deducted from the net assets of an investment company and does not include a service fee.

(B) A "deferred sales charge" is any amount properly chargeable to sales or promotional expenses that is paid by a shareholder after purchase but before or upon redemption.

(C) A "front-end sales charge" is a sales charge that is included in the public offering price of the shares of an investment company.

(9) "Service fees," as used in paragraph (d), shall mean payments by an investment company for personal service and/or the maintenance of shareholder accounts.

(10) The terms "underwriter," "principal underwriter," "redeemable security," "periodic payment plan," "open-end company," "closed-end company" and "unit investment trust," shall have the same definitions used in the Investment Company Act.

(11) A "fund of funds" is an investment company that acquires securities issued by any other investment company registered under the Investment Company Act in excess of the amounts permitted under paragraph (A) of Section 12(d)(1) of the Investment Company Act. An "acquiring company" in a fund of funds is the investment company that purchases or otherwise acquires the securities of another investment company, and an "acquired company" is the investment company whose securities are acquired.

(12) "Investment companies in a single complex" are any two or more companies that hold themselves out to investors as related companies for purposes of investment and investor services.

### **(c) Conditions for Discounts to Dealers**

No member who is an underwriter of the securities of an investment company shall sell any such security to any dealer or broker at any price other than a public offering price unless such sale is in conformance with Rule 2040 and, if the security is issued by an open-end company or by a unit investment trust which invests primarily in securities issued by other investment companies, unless a sales agreement is in effect between the parties as of the date of the transaction, which agreement shall set forth the concessions to be received by the dealer or broker.

### **(d) Sales Charge**

No member shall offer or sell the shares of any open-end company, any closed-end company that makes periodic repurchase offers pursuant to Rule 23c-3(b) under the Investment Company Act and offers its shares on a continuous basis pursuant to Rule 415(a)(1)(xi) under the Securities Act, or any "single payment" investment plan issued by a unit investment trust (collectively "investment companies") registered under the Investment Company Act if the sales charges described in the prospectus are excessive. Aggregate sales charges shall be deemed excessive if they do not conform to the following provisions:

#### **(1) Investment Companies Without an Asset-Based Sales Charge**

(A) Aggregate front-end and deferred sales charges described in the prospectus which may be imposed by an investment company without an asset-based sales charge

(B)(i) Rights of accumulation (cumulative quantity discounts) may be made available to any person in accordance with one of the alternative quantity discount schedules provided in paragraph (d)(1)(C)(i) below, as in effect on the date the right is exercised.

(ii) If rights of accumulation are not made available on terms at least as favorable as those specified in paragraph (d)(1)(C)(i) the maximum aggregate sales charge shall not exceed 8.0% of offering price.

(C)(i) Quantity discounts, if offered, shall be made available on single purchases by any person in accordance with one of the following two alternatives:

a. A maximum aggregate sales charge of 7.75% on purchases of \$10,000 or more and a maximum aggregate sales charge of 6.25% on purchases of \$25,000 or more; or

b. A maximum aggregate sales charge of 7.50% on purchases of \$15,000 or more and a maximum aggregate sales charge of 6.25% on purchases of \$25,000 or more.

(ii) If quantity discounts are not made available on terms at least as favorable as those specified in paragraph (d)(1)(C)(i) the maximum aggregate sales charge shall not exceed:

a. 7.75% of offering price if the provisions of paragraphs (d)(1)(B) are met.

b. 7.25% of offering price if the provisions of paragraph (d)(1)(B) are not met.

(D) If an investment company without an asset-based sales charge pays a service fee, the maximum aggregate sales charge shall not exceed 7.25% of the offering price.

## **(2) Investment Companies with an Asset-Based Sales Charge**

(A) Except as provided in paragraphs (d)(2)(C) and (D), the aggregate asset-based, front-end and deferred sales charges described in the prospectus which may be imposed by an investment company with an asset-based sales charge, if the investment company has adopted a plan under which service fees are paid, shall not exceed 6.25% of total new gross sales (excluding sales from the reinvestment of distributions and exchanges of shares between investment companies in a single complex, between classes of an investment company with multiple classes of shares or between series of a series investment company) plus interest charges on such amount equal to the prime rate plus

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one percent per annum. The maximum front-end or deferred sales charge resulting from any transaction shall be 6.25% of the amount invested.

(B) Except as provided in paragraphs (d)(2)(C) and (D), if an investment company with an asset-based sales charge does not pay a service fee, the aggregate asset-based, front-end and deferred sales charges described in the prospectus shall not exceed 7.25% of total new gross sales (excluding sales from the reinvestment of distributions and exchanges of shares between investment companies in a single complex, between classes of an investment company with multiple classes of shares or between series of a series investment company) plus interest charges on such amount equal to the prime rate plus one percent per annum. The maximum front-end or deferred sales charge resulting from any transaction shall be 7.25% of the amount invested.

(C) The maximum aggregate sales charge on total new gross sales set forth in paragraphs (d)(2)(A) and (B) may be increased by an amount calculated by applying the appropriate percentages of 6.25% or 7.25% to total new gross sales which occurred after an investment company first adopted an asset-based sales charge until July 7, 1993 plus interest charges on such amount equal to the prime rate plus one percent per annum less any front-end, asset-based or deferred sales charges on such sales or net assets resulting from such sales.

(D) The maximum aggregate sales charges of an investment company in a single complex, a class of shares issued by an investment company with multiple classes of shares or a separate series of a series investment company, may be increased to include sales of exchanged shares provided that such increase is deducted from the maximum aggregate sales charges of the investment company, class or series which redeemed the shares for the purpose of such exchanges.

(E) No member shall offer or sell the shares of an investment company with an asset-based sales charge if:

(i) The amount of the asset-based sales charge exceeds .75 of 1% per annum of the average annual net assets of the investment company; or

(ii) Any deferred sales charges deducted from the proceeds of a redemption after the maximum cap described in paragraphs (d)(2)(A), (B), (C) and (D) hereof, has been attained are not credited to the investment company.

### **(3) Fund of Funds**

(A) If neither an acquiring company nor an acquired company in a fund of funds structure has an asset-based sales charge, the maximum aggregate front-end and deferred sales charges that may be imposed by the acquiring company, the acquired

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company and those companies in combination, shall not exceed the rates provided in paragraph (d)(1).

(B) Any acquiring company or acquired company in a fund of funds structure that has an asset-based sales charge shall individually comply with the requirements of paragraph (d)(2), provided:

(i) If the acquiring and acquired companies are in a single complex and the acquired fund has an asset-based sales charge, sales made to the acquiring fund shall be excluded from total gross new sales for purposes of acquired fund's calculations under paragraphs (d)(2)(A) through (d)(2)(D); and

(ii) If both the acquiring and acquired companies have an asset-based sales charge:

a. the maximum aggregate asset-based sales charge imposed by the acquiring company, the acquired company and those companies in combination, shall not exceed the rate provided in paragraph (d)(2)(E)(i); and

b. the maximum aggregate front-end or deferred sales charges shall not exceed 7.25% of the amount invested, or 6.25% if either company pays a service fee.

(C) The rates described in paragraphs (d)(4) and (d)(5) shall apply to the acquiring company, the acquired company and those companies in combination. The limitations of paragraph (d)(6) shall apply to the acquiring company and the acquired company individually.

(4) No member or person associated with a member shall, either orally or in writing, describe an investment company as being "no load" or as having "no sales charge" if the investment company has a front-end or deferred sales charge or whose total charges against net assets to provide for sales related expenses and/or service fees exceed .25 of 1% of average net assets per annum.

(5) No member or person associated with a member shall offer or sell the securities of an investment company if the service fees paid by the investment company, as disclosed in the prospectus, exceed .25 of 1% of its average annual net assets or if a service fee paid by the investment company, as disclosed in the prospectus, to any person who sells its shares exceeds .25 of 1% of the average annual net asset value of such shares.

(6) No member or person associated with a member shall offer or sell the securities of an investment company if:



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(A) The investment company has a deferred sales charge paid upon redemption that declines over the period of a shareholder's investment ("contingent deferred sales load"), unless the contingent deferred sales load is calculated as if the shares or amounts representing shares not subject to the load are redeemed first, and other shares or amounts representing shares are then redeemed in the order purchased, provided that another order of redemption may be used if such order would result in the redeeming shareholder paying a lower contingent deferred sales load; or

(B) The investment company has a front-end or deferred sales charge imposed on shares, or amounts representing shares, that are purchased through the reinvestment of dividends, unless the registration statement registering the investment company's securities under the Securities Act became effective prior to April 1, 2000.

#### **(e) Selling Dividends**

No member shall, in recommending the purchase of investment company securities, state or imply that the purchase of such securities shortly before an ex-dividend date is advantageous to the purchaser, unless there are specific, clearly described tax or other advantages to the purchaser, and no member shall represent that distributions of long-term capital gains by an investment company are or should be viewed as part of the income yield from an investment in such company's securities.

#### **(f) Withhold Orders**

No member shall withhold placing customers' orders for any investment company security so as to profit as a result of such withholding.

#### **(g) Purchase for Existing Orders**

No member shall purchase from an underwriter the securities of any open-end company and no member who is an underwriter of such securities shall purchase such securities from the issuer, except (1) for the purpose of covering purchase orders previously received or (2) for its own investment. Nothing herein shall be deemed to prohibit any member from purchasing securities of any investment company specifically designed for short-term investment (e.g., money market fund).

#### **(h) Refund of Sales Charge**

If any security issued by an open-end company is repurchased by the issuer, or by the underwriter for the account of the issuer, or is tendered for redemption within seven business days after the date of the transaction, (1) the dealer or broker shall forthwith refund to the underwriter the full concession allowed to the dealer or broker on the original sale and (2) the underwriter shall forthwith pay to the issuer the underwriter's share of the sales charge on the original sale by the underwriter and shall also pay to the issuer the refund which it received under paragraph (d)(1) when it receives such refund. The dealer or broker shall be notified by the underwriter of such repurchase or

redemption within ten days of the date on which the certificate or written request for redemption is delivered to the underwriter or issuer. If the original sale was made directly to the investor by the principal underwriter, the entire sales charge shall be paid to the issuer by the principal underwriter.

**(i) Purchases as Principal**

No member who is a party to a sales agreement referred to in paragraph (c) shall, as principal, purchase any security issued by an open-end company or unit investment trust from a record holder at a price lower than the bid price next quoted by or for the issuer.

**(j) Repurchase from Dealer**

No member who is a principal underwriter of a security issued by an open-end company or a closed-end company that makes periodic repurchase offers pursuant to Rule 23c-3(b) under the Investment Company Act and offers its shares on a continuous basis pursuant to Rule 415(a)(1)(xi) under the Securities Act shall repurchase such security, either as principal or as agent for the issuer, from a dealer acting as principal who is not a party to a sales agreement with a principal underwriter, nor from any investor, unless such dealer or investor is the record owner of the security so tendered for repurchase. No member who is a principal underwriter shall participate in the offering or in the sale of any such security if the issuer voluntarily redeems or repurchases its securities from a dealer acting as principal who is not a party to such a sales agreement nor from any investor, unless such dealer or investor is the record owner of the security so tendered for repurchase. Nothing in this paragraph shall relate to the compulsory redemption of any security upon presentation to the issuer pursuant to the terms of the security.

Nothing in this Rule shall prevent any member, whether or not a party to a sales agreement, from selling any such security for the account of a record owner to the underwriter or issuer at the bid price next quoted by or for the issuer and charging the investor to a reasonable charge for handling the transaction, provided that such member discloses to such record owner that direct redemption of the security can be accomplished by the record owner without incurring such charges.

**(k) Execution of Investment Company Portfolio Transactions**

(1) No member shall, directly or indirectly, favor or disfavor the sale or distribution of shares of any particular investment company or group of investment companies on the basis of brokerage commissions received or expected by such member from any source, including such investment company, or any covered account.

(2) No member shall sell shares of, or act as underwriter for, an investment company, if the member knows or has reason to know that such investment company, or an investment adviser or principal underwriter of the company, has a written or oral agreement or understanding under which the company directs or is expected to direct portfolio securities transactions (or any commission, markup or other remuneration resulting from any such transaction) to a broker or a

dealer in consideration for the promotion or sale of shares issued by the company or any other registered investment company.

(3) No member shall, directly or indirectly, demand or require brokerage commissions or solicit a promise of such commissions from any source as a condition to the sale or distribution of shares of an investment company.

(4) No member shall, directly or indirectly, offer or promise to another member, brokerage commissions from any source as a condition to the sale or distribution of shares of an investment company and no member shall request or arrange for the direction to any member of a specific amount or percentage of brokerage commissions conditioned upon that member's sales or promise of sales of shares of an investment company.

(5) No member shall circulate any information regarding the amount or level of brokerage commissions received by the member from any investment company or covered account to other than management personnel who are required, in the overall management of the member's business, to have access to such information.

(6) No member shall, with respect to such member's activities as underwriter of investment company shares, suggest, encourage, or sponsor any incentive campaign or special sales effort of another member with respect to the shares of any investment company which incentive or sales effort is, to the knowledge or understanding of such underwriter-member, to be based upon, or financed by, brokerage commissions directed or arranged by the underwriter-member.

(7) No member shall, with respect to such member's retail sales or distribution of investment company shares:

(A) provide to salesmen, branch managers or other sales personnel any incentive or additional compensation for the sale of shares of specific investment companies based on the amount of brokerage commissions received or expected from any source, including such investment companies or any covered account. Included in this prohibition are bonuses, preferred compensation lists, sales incentive campaign or contests, or any other method of compensation which provides an incentive to sales personnel to favor or disfavor any investment company or group of investment companies based on brokerage commissions;

(B) recommend specific investment companies to sales personnel, or establish "recommended," "selected," or "preferred" lists of investment companies, regardless of the existence of any special compensation or incentives to favor or disfavor the shares of such company or companies in sales efforts, if such companies are recommended or selected on the basis of brokerage commissions received or expected from any source;

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(C) grant to salesmen, branch managers or other sales personnel any participation in brokerage commissions received by such member from portfolio transactions of an investment company whose shares are sold by such member, or from any covered account, if such commissions are directed by, or identified with, such investment company or any covered account; or

(D) use sales of shares of any investment company as a factor in negotiating the price of, or the amount of brokerage commissions to be paid on, a portfolio transaction of an investment company or of any covered account, whether such transaction is executed in the over-the-counter market or elsewhere.

(8) Provided that the member does not violate any of the specific provisions of this paragraph (k), nothing herein shall be deemed to prohibit:

(A) the execution of portfolio transactions of any investment company or covered account by members who also sell shares of the investment company; or

(B) a member from compensating its salesmen and managers based on total sales of investment company shares attributable to such salesmen or managers, whether by use of overrides, accounting credits, or other compensation methods, provided that such compensation is not designed to favor or disfavor sales of shares of particular investment companies on a basis prohibited by this paragraph (k).

## **(I) Member Compensation**

In connection with the sale and distribution of investment company securities:

(1) Except as described below, no associated person of a member shall accept any compensation from anyone other than the member with which the person is associated. This requirement will not prohibit arrangements where a non-member company pays compensation directly to associated persons of the member, provided that:

(A) the arrangement is agreed to by the member;

(B) the member relies on an appropriate rule, regulation, interpretive release, interpretive letter, or "no-action" letter issued by the SEC or its staff that applies to the specific fact situation of the arrangement;

(C) the receipt by associated persons of such compensation is treated as compensation received by the member for purposes of FINRA rules; and

(D) the recordkeeping requirement in paragraph (I)(3) is satisfied.

(2) No member or person associated with a member shall accept any compensation from an offeror which is in the form of securities of any kind.

(3) Except for items described in subparagraphs (I)(5)(A) and (B), a member shall maintain records of all compensation received by the member or its associated persons from offerors. The records shall include the names of the offerors, the names of the associated persons, the amount of cash, the nature and, if known, the value of non-cash compensation received.

(4) No member shall accept any cash compensation from an offeror unless such compensation is described in a current prospectus of the investment company. When special cash compensation arrangements are made available by an offeror to a member, which arrangements are not made available on the same terms to all members who distribute the investment company securities of the offeror, a member shall not enter into such arrangements unless the name of the member and the details of the arrangements are disclosed in the prospectus. Prospectus disclosure requirements shall not apply to cash compensation arrangements between:

(A) principal underwriters of the same security; and

(B) the principal underwriter of a security and the sponsor of a unit investment trust which utilizes such security as its underlying investment.

(5) No member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided below. Notwithstanding the provisions of paragraph (I)(1), the following non-cash compensation arrangements are permitted provided that they are consistent with the applicable requirements of SEA Rule 15I-1 ("Regulation Best Interest"):

(A) Gifts that do not exceed an annual amount per person fixed periodically by FINRA<sup>1</sup> and are not preconditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) the recordkeeping requirement in paragraph (I)(3) is satisfied;

(ii) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not preconditioned by

the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (I)(5)(D);

(iii) the location is appropriate to the purpose of the meeting, which shall mean an office of the offeror or the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iv) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(v) the payment or reimbursement by the offeror is not preconditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (I)(5)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member, provided that:

(i) the member's or non-member's non-cash compensation arrangement, if it includes investment company securities, is based on the total production of associated persons with respect to all investment company securities distributed by the member;

(ii) the non-cash compensation arrangement requires that the credit received for each investment company security is equally weighted;

(iii) no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(iv) the recordkeeping requirement in paragraph (I)(3) is satisfied.

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (I)(5)(D).

### **(m) Prompt Payment for Investment Company Shares**

(1) Members (including underwriters) that engage in direct retail transactions for investment company shares shall transmit payments received from customers for such shares, which such members have sold to customers, to payees (i.e., underwriters, investment companies or their designated agents) by (A) the end of the second business day following a receipt of a customer's order to purchase such shares or by (B) the end of one business day following receipt of a customer's payment for such shares, whichever is the later date.

(2) Members that are underwriters and that engage in wholesale transactions for investment company shares shall transmit payments for investment company shares, which such members have received from other members, to investment company issuers or their designated agents by the end of two business days following receipt of such payments.

#### **(n) Disclosure of Deferred Sales Charges**

In addition to the requirements for disclosure on written confirmations of transactions contained in Rule 2232, if the transaction involves the purchase of shares of an investment company that imposes a deferred sales charge on redemption, such written confirmation shall also include the following legend: "On selling your shares, you may pay a sales charge. For the charge and other fees, see the prospectus." The legend shall appear on the front of a confirmation and in, at least, 8-point type.

<sup>1</sup> The current annual amount fixed by FINRA is \$100.

Amended by SR-FINRA-2020-007 eff. June 30, 2020.  
Amended by SR-FINRA-2016-047 eff. Sept. 5, 2017.  
Amended by SR-FINRA-2016-019 eff. July 9, 2016.  
Amended by SR-NASD-2004-027 eff. Feb. 14, 2005.  
Amended by SR-NASD-99-74 eff. June 20, 2000.  
Amended by SR-NASD-98-14 eff. April 1, 2000.  
Amended by SR-NASD-97-35 eff. Jan. 1, 1999.  
Amended by SR-NASD-94-56 eff. June 7, 1995.  
Amended by SR-NASD-93-42 eff. Feb. 24, 1994.  
Amended by SR-NASD-90-69 eff. July 7, 1993.  
Amended by SR-NASD-90-56 eff. Oct. 1, 1991.  
Amended by SR-NASD-86-34 eff. Oct. 31, 1988.  
Amended by SR-NASD-84-51 eff. July 10, 1984.  
Amended by SR-NASD-80-21 eff. Mar. 4, 1981.  
Amended by SR-NASD-75-13 eff. May 1, 1976.  
Amended by SEC Release No. 10147 eff. July 15, 1973.  
Amended eff. Feb. 8, 1971.  
Adopted by SEC Release No. 2866 eff. June 1, 1941.

**Selected Notices to Members:** 73-42, 75-68, 75-70, 80-07, 80-13, 80-43, 81-08, 84-40, 85-86, 88-96, 89-51, 91-40, 91-68, 92-41, 93-12, 93-52, 93-82, 94-13, 94-14, 94-16, 94-41, 94-67, 95-36, 95-56, 97-48, 97-50, 98-75; 99-55, 99-103, 00-53, 05-04, 17-19, 20-18.

## 2342. "Breakpoint" Sales

The Rule

Notices

(a) No member shall sell investment company shares in dollar amounts just below the point at which the sales charge is reduced on quantity transactions so as to share in the higher sales charges applicable on sales below the breakpoint.

(b) For purposes of determining whether a sale in dollar amounts just below a breakpoint was made in order to share in a higher sales charge, FINRA will consider the facts and circumstances, including, for example, whether a member has retained records that demonstrate that the trade was executed in accordance with a bona fide asset allocation program that the member offers to its customers:

(1) which is designed to meet their diversification needs and investment goals; and

(2) under which the member discloses to its customers that they may not qualify for breakpoint reductions that are otherwise available.

Amended by SR-FINRA-2009-018 eff. Aug. 17, 2009.

Amended by SR-NASD-99-74 eff. June 20, 2000.

Amended by SR-NASD-98-69 eff. Dec. 15, 1998.

**Selected Notices:** 98-98, 00-53, 09-33.



# 2351. General Provisions Applicable to Trading in Index Warrants, Currency Index Warrants and Currency Warrants

The Rule

Notices

## (a) General

(1) Applicability — This Rule 2350 Series shall be applicable to the extent appropriate unless otherwise stated herein, to the conduct of accounts, the execution of transactions, and the handling of orders in exchange-listed stock index warrants, currency index warrants, and currency warrants by members who are not members of the exchange on which the warrant is listed or traded.

(2) Except to the extent that specific provisions in this Rule Series govern, or unless the context otherwise requires, the provisions of the FINRA By-Laws, rules and all other interpretations and policies shall also be applicable to transactions in index warrants, currency index warrants, and currency warrants.

(3) The Rules in this Rule 2350 Series are not applicable to stock index warrants, currency index warrants, and currency warrants listed on national securities exchanges prior to September 28, 1995.

## (b) Definitions

(1) The term "control" shall have the same meaning as the term "control" as set forth in Rule 2360(a)(6).

(2) The term "currency index" means a group of currencies each of whose inclusion and relative representation in the group is determined by its inclusion and relative representation in a currency index.

(3) The term "currency index warrants" shall mean instruments that are direct obligations of the issuing company, either exercisable throughout their life (i.e., American style) or exercisable only on their expiration date (i.e., European style), entitling the holder thereof to a cash settlement in U.S. dollars to the extent that the value of the underlying currency index has declined below (in the case of a put warrant) or increased above (in the case of a call warrant) the pre-stated cash settlement value of the underlying currency index.

(4) The term "currency warrants" shall mean instruments that are direct obligations of the issuing company, either exercisable throughout their life (i.e., American style) or exercisable only

on their expiration date (i.e., European style), entitling the holder thereof to a cash settlement in U.S. dollars to the extent that the value of the underlying foreign currency has declined below (in the case of a put warrant) or increased above (in the case of a call warrant) the pre-stated cash settlement value of the underlying foreign currency. The term "foreign currency warrants" shall also include cross-rate currency warrants.

(5) The term "index warrants" means instruments that are direct obligations of the issuing company, either exercisable throughout their life (i.e., American style) or exercisable only on their expiration date (i.e., European style), entitling the holder thereof to a cash settlement in U.S. dollars to the extent that the value of the underlying stock index group has declined below (in the case of a put warrant) or increased above (in the case of a call warrant) the pre-stated cash settlement value of the underlying stock index group.

(6) The term "stock index group" means a group of stocks each of whose inclusion and relative representation in the group is determined by its inclusion and relative representation in a stock index.

Amended by SR-FINRA-2008-032 eff. Feb. 17, 2009.

Amended by SR-NASD-2005-087 eff. Aug. 1, 2006.

Adopted by SR-NASD-95-37 eff. Sept. 28, 1995.

**Selected Notices:** 95-82, 08-57, 08-78.

## 2352. Account Approval

The Rule

Notices

No member or person associated with a member shall accept an order from a customer to purchase or sell an index warrant, currency index warrant, or currency warrant unless the customer's account has been approved for options trading pursuant to Rule 2360(b)(16).

Amended by SR-FINRA-2008-032 eff. Feb. 17, 2009.

Adopted by SR-NASD-95-37 eff. Sept. 28, 1995.

**Selected Notices:** 95-82, 08-57, 08-78.

## 2353. Suitability

The Rule

Notices

The provisions of Rule 2360(b)(19) shall apply to recommendations by members and persons associated with members regarding the purchase or sale of index warrants, currency index warrants, or currency warrants. The term "option" as used therein shall be deemed to include such warrants for purposes of this Rule.

Amended by SR-FINRA-2008-032 eff. Feb. 17, 2009.

Adopted by SR-NASD-95-37 eff. Sept. 28, 1995.

**Selected Notices:** 95-82, 08-57, 08-78.

## 2354. Discretionary Accounts

The Rule

Notices

Insofar as a member or person associated with a member exercises discretion to trade in index warrants, currency index warrants, or currency warrants in a customer's account, such account shall be subject to the provisions of [Rule 2360\(b\)\(18\)](#). The term "option" as used therein shall be deemed to include such warrants for purposes of this Rule.

Amended by SR-FINRA-2008-032 eff. Feb. 17, 2009.

Adopted by SR-NASD-95-37 eff. Sept. 28, 1995.

**Selected Notices:** [95-82](#), [08-57](#), [08-78](#).

## 2355. Supervision of Accounts

The Rule

Notices

The provisions of Rule 2360(b)(20) shall apply to all customer accounts of a member in which transactions in index warrants, currency index warrants, or currency warrants are effected. The term "option" as used therein shall be deemed to include such warrants for purposes of this Rule.

Amended by SR-FINRA-2008-032 eff. Feb. 17, 2009.

Adopted by SR-NASD-95-37 eff. Sept. 28, 1995.

**Selected Notices:** 95-82, 08-57, 08-78.

## 2356. Customer Complaints

The Rule

Notices

The record-keeping requirements of Rule 2360(b)(17)(A) concerning the receipt and handling of customer complaints relating to options shall also apply to customer complaints relating to index warrants, currency index warrants, or currency warrants and the required records of such complaints shall be maintained together with the records pertaining to options related complaints, provided that complaints related to index warrants, currency index warrants, or currency warrants shall be clearly identified as such. The term "option" as used therein shall be deemed to include such warrants for purposes of this Rule.

Amended by SR-FINRA-2008-032 eff. Feb. 17, 2009.

Adopted by SR-NASD-95-37 eff. Sept. 28, 1995.

**Selected Notices:** 95-82, 08-57, 08-78.

# 2357. Communications with the Public and Customers Concerning Index Warrants, Currency Index Warrants and Currency Warrants

The Rule

Notices

The provisions of Rule 2220 shall be applicable to communications to customers regarding index warrants, currency index warrants, or currency warrants. The term "option" as used therein shall be deemed to include such warrants for purposes of this Rule and the term "The Options Clearing Corporation" shall be deemed to mean the issuer of such warrants.

Amended by SR-FINRA-2009-078 eff. Dec. 14, 2009.  
Amended by SR-FINRA-2008-032 eff. Feb. 17, 2009.  
Adopted by SR-NASD-95-37 eff. Sept. 28, 1995.

**Selected Notice to Members:** 95-82, 08-57, 08-78.



## 2358. Maintenance of Records

The Rule

Notices

The record-keeping provisions of Rule 2360(b)(17)(B) shall be applicable to customer accounts approved to trade index warrants, currency index warrants, or currency warrants. The term "option" as used therein shall be deemed to include such warrants for purposes of this Rule.

Amended by SR-FINRA-2008-032 eff. Feb. 17, 2009.

Adopted by SR-NASD-95-37 eff. Sept. 28, 1995.

**Selected Notices:** 95-82, 08-57, 08-78.

# 2359. Position and Exercise Limits; Liquidations

The Rule

Notices

## (a) Position Limits

Except with the prior written approval of FINRA pursuant to the Rule 9600 Series for good cause shown, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, a purchase or sale transaction in an index warrant listed on a national securities exchange if the member has reason to believe that as a result of such transaction the member, or partner, officer, director or employee thereof, or customer would, acting alone or in concert with others, directly or indirectly, hold or control an aggregate position in an index warrant issue on the same side of the market, combining such index warrant position with positions in index warrants overlying the same index on the same side of the market, in excess of the position limits established by the exchange on which the index warrant is listed.

## (b) Exercise Limits

(1) Except with the prior written approval of FINRA pursuant to the Rule 9600 Series for good cause shown, in each instance, no member or person associated with a member shall exercise, for any account in which such member or person associated with such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, a long position in any index warrant if as a result thereof such member or partner, officer, director or employee thereof or customer, acting alone or in concert with others, directly or indirectly, has or will have exceeded the applicable exercise limit fixed from time to time by an exchange for an index warrant.

(2) FINRA, pursuant to the Rule 9600 Series for good cause shown, may institute other limitations concerning the exercise of index warrants from time to time. Reasonable notice shall be given of each new limitation fixed by FINRA. These exercise limitations are separate and distinct from any other exercise limitations imposed by the issuers of index warrants.

## (c) Liquidations

(1) Whenever FINRA determines that a person or group of persons acting in concert holds or controls an aggregate position (whether short or long) in index warrants overlying the same index in excess of the position limitations established by paragraph (a), it may, when deemed necessary or appropriate in the public interest and for the protection of investors, direct any member or all members carrying a position in index warrants overlying such index for such person or persons to liquidate such position or positions, or portions thereof, as expeditiously as

possible and consistent with the maintenance of an orderly market, so as to bring such person or persons into compliance with the position limitations contained in paragraph (a).

(2) Whenever such a directive is issued by FINRA no member receiving notice thereof shall accept and/or execute for any person or persons named in such directive any order to purchase or sell short any index warrants based on the same index, unless in each instance express approval therefor is given by FINRA, or the directive is rescinded.

Amended by SR-FINRA-2008-032 eff. Feb. 17, 2009.

Amended by SR-NASD-2005-087 eff. Aug. 1, 2006

Amended by SR-NASD-97-28 eff. Aug. 7, 1997.

Adopted by SR-NASD-95-37 eff. Sept. 28, 1995.

**Selected Notices:** 95-82, 08-57, 08-78.

# 2360. Options

The Rules

Notices

## (a) Definitions

The following terms shall, unless the context otherwise requires, have the stated meanings:

(1) **Aggregate Exercise Price** — The term "aggregate exercise price" means the exercise price of an option contract multiplied by the number of units of the underlying security covered by such option contract.

(2) **Call** — The term "call" means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to purchase the number of units of the underlying security or to receive a dollar equivalent of the underlying index covered by the option contract. In the case of a "call" issued by The Options Clearing Corporation on common stock, it shall mean an option contract under which the holder of the option has the right, in accordance with the terms of the option, to purchase from The Options Clearing Corporation the number of units of the underlying security or receive a dollar equivalent of the underlying index covered by the option contract.

(3) **Class of Options** — The term "class of options" means all option contracts of the same type of option covering the same underlying security or index.

(4) **Clearing Member** — The term "clearing member" means a FINRA member which has been admitted to membership in The Options Clearing Corporation pursuant to the provisions of the rules of The Options Clearing Corporation.

(5) **Closing Sale Transaction** — The term "closing sale transaction" means an option transaction in which the seller's intention is to reduce or eliminate a long position in the series of options involved in such transaction.

### (6) Control

(A) The term "control" means the power or ability of an individual or entity to make investment decisions for an account or accounts, or influence directly or indirectly the investment decisions of any person or entity who makes investment decisions for an account. In addition, control will be presumed in the following circumstances:

(i) among all parties to a joint account who have authority to act on behalf of the account;

(ii) among all general partners to a partnership account;

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(iii) when a person or entity:

a. holds an ownership interest of 10 percent or more in an entity (ownership interest of less than 10 percent will not preclude aggregation), or

b. shares in 10 percent or more of profits and/or losses of an account;

(iv) when accounts have common directors or management;

(v) where a person or entity has the authority to execute transactions in an account.

(B) Control, presumed by one or more of the above powers, abilities or circumstances, can be rebutted by proving the factor does not exist or by showing other factors which negate the presumption of control. The rebuttal proof must be submitted by affidavit and/or such other evidence as may be appropriate in the circumstances.

(C) FINRA will also consider the following factors in determining if aggregation of accounts is required:

(i) similar patterns of trading activity among separate entities;

(ii) the sharing of kindred business purposes and interests;

(iii) whether there is common supervision of the entities which extends beyond assuring adherence to each entity's investment objectives and/or restrictions;

(iv) the degree of contact and communication between directors and/or managers of separate accounts.

(7) Controls, Is Controlled by or Is Under Common Control With — The terms "controls," "is controlled by" and "is under common control with" shall have the meanings specified in Rule 405 of SEC Regulation C.

(8) Conventional Index Option — The term "conventional index option" means any options contract not issued, or subject to issuance, by The Options Clearing Corporation, or an OCC Cleared OTC Option, that, as of the trade date, overlies a basket or index of securities that:

(A) Underlies a standardized index option; or

(B) Satisfies the following criteria:

(i) The basket or index comprises 9 or more equity securities;

(ii) No equity security comprises more than 30% of the equity security component of the basket's or index's weighting; and

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(iii) Each equity security comprising the basket or index:

a. is a component security in either the Russell 3000 Index or the FTSE All-World Index Series; or

b. has

1. market capitalization of at least \$75 million or, in the case of the lowest weighted component securities in the basket or index that in the aggregate account for no more than 10% of the weight of the index, \$50 million; and

2. trading volume for each of the preceding six months of at least one million shares or, in the case of each of the lowest weighted component securities in the basket or index that in the aggregate account for no more than 10% of the weight of the index, 500,000 shares.

(9) Conventional Option — The term "conventional option" shall mean: (A) any option contract not issued, or subject to issuance, by The Options Clearing Corporation; or (B) an OCC Cleared OTC Option.

(10) Covered — The term "covered" in respect of a short position in a call option contract means that the writer's obligation is secured by a "specific deposit" or an "escrow deposit," meeting the conditions of Rules 610(e) or 610(g), respectively, of the rules of The Options Clearing Corporation, or the writer holds in the same account as the short position, on a unit-for-unit basis, a long position either in the underlying security or in an option contract of the same class of options where the exercise price of the option contract in such long position is equal to or less than the exercise price of the option contract in such short position. The term "covered" in respect of a short position in a put option contract means that the writer holds in the same account as the short position, on a unit-for-unit basis, a long position in an option contract of the same class of options having an exercise price equal to or greater than the exercise price of the option contract in such short position.

(11) Delta Neutral — The term "delta neutral" describes an equity options position that has been fully hedged, in accordance with a Permitted Pricing Model as defined in paragraph (b)(3)(A)(ii)b. with a portfolio of instruments including or relating to the same underlying security to offset the risk that the value of the equity options position will change with incremental changes in the price of the security underlying the options position.

(12) Disclosure Document(s) — The term "disclosure document" or "disclosure documents" shall mean those documents filed with the SEC, prepared by one or more options markets and meeting the requirements of SEA Rule 9b-1. They shall contain general explanatory information relating to the mechanics of buying, writing and exercising options; the risks involved, the uses of

and market for the options; transaction costs and applicable margin requirements; tax consequences of trading options; identification of the options issuer and the instrument underlying the options class; and the availability of the prospectus and the information in Part II of the registration statement.

(13) Exercise Price — The term "exercise price" in respect of an option contract means the stated price per unit at which the underlying security may be purchased (in the case of a call) or sold (in the case of a put) upon the exercise of such option contract.

(14) Expiration Date — The term "expiration date" of an option contract issued by The Options Clearing Corporation means the day and time fixed in accordance with the rules of The Options Clearing Corporation for the expiration of such option contract. The term "expiration date" of all other option contracts means the date specified thereon for such.

(15) Expiration Month — The term "expiration month" in respect of an option contract means the month and year in which such option contract expires.

(16) FLEX Equity Option — The term "FLEX Equity Option" means any options contract issued, or subject to issuance by, The Options Clearing Corporation, other than an OCC Cleared OTC Option, whereby the parties to the transaction have the ability to negotiate the terms of the contract consistent with the rules of the exchange on which the options contract is traded.

(17) Long Position — The term "long position" means the number of outstanding option contracts of a given series of options held by a person (purchaser).

(18) Net Delta — The term "net delta" means the number of shares that must be maintained (either long or short) to offset the risk that the value of an equity options position will change with incremental changes in the price of the security underlying the options position.

(19) OCC Cleared OTC Option — The term "OCC Cleared OTC Option" means any put, call, straddle or other option or privilege that meets the definition of an "option" under Rule 2360(a)(21), and is cleared by The Options Clearing Corporation, is entered into other than on or through the facilities of a national securities exchange, and is entered into exclusively by persons who are "eligible contract participants" as defined in the Exchange Act.

(20) Opening Writing Transaction — The term "opening writing transaction" means an option transaction in which the seller's (writer's) intention is to create or increase a short position in the series of options involved in such transaction.

(21) Option — The term "option" shall mean any put, call, straddle or other option or privilege, which is a "security" as defined in Section 2(1) of the Securities Act, as amended, but shall not include any (A) tender offer, (B) registered warrant, (C) right, (D) convertible security or

(E) any other option in respect to which the writer (seller) is the issuer of the security which may be purchased or sold upon the exercise of the option.

(22) Option Transaction — The term "option transaction" means a transaction effected by a member for the purchase or sale of an option contract, or for the closing out of a long or short position in such option.

(23) Options Contract — The term "options contract" means any option as defined in paragraph (a)(21). For purposes of paragraphs (b)(3) through (12), an option to purchase or sell common stock shall be deemed to cover 100 shares of such stock at the time the contract granting such option is written. If a stock option is granted covering some other number of shares, then for purposes of paragraphs (b)(3) through (12), it shall be deemed to constitute as many option contracts as that other number of shares divided by 100 (e.g., an option to buy or sell five hundred shares of common stock shall be considered as five option contracts). A stock option contract that, when written, grants the right to purchase or sell 100 shares of common stock shall continue to be considered as one contract throughout its life, notwithstanding that, pursuant to its terms, the number of shares that it covers may be adjusted to reflect stock dividends, stock splits, reverse splits, or other similar actions by the issuer of such stock.

(24) Options Contract Equivalent of the Net Delta — the term "options contract equivalent of the net delta" means the net delta divided by the number of shares underlying the options contract.

(25) Options Trading — The term "options trading" means trading (A) in any option issued by The Options Clearing Corporation, and (B) in any conventional option.

(26) Outstanding — The term "outstanding" in respect of an option contract means an option contract which has neither been the subject of a closing sale transaction nor has been exercised nor reached its expiration date.

(27) Premium — The term "premium" means the aggregate price of the option contracts agreed upon between the buyer and writer/seller or their agents.

(28) Put — The term "put" means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to sell the number of units of the underlying security or deliver a dollar equivalent of the underlying index covered by the option contract. In the case of a "put" issued by The Options Clearing Corporation on common stock, it shall mean an option contract under which the holder of the option has the right, in accordance with terms of the option, to sell to The Options Clearing Corporation the number of units of the underlying security covered by the option contract or to tender the dollar equivalent of the underlying index.



(29) Rules of The Options Clearing Corporation — The term "rules of The Options Clearing Corporation" means the by-laws and the rules of The Options Clearing Corporation, and all written interpretations thereof as may be in effect from time to time.

(30) Series of Options — The term "series of options" means all option contracts of the same class of options having the same exercise price and expiration date and which cover the same number of units of the underlying security or index.

(31) Short Position — The term "short position" means the number of outstanding option contracts of a given series of options with respect to which a person is obligated as a writer (seller).

(32) Standardized Equity Option — The term "standardized equity option" means any equity options contract issued, or subject to issuance by, The Options Clearing Corporation that is not a FLEX Equity Option and not an OCC Cleared OTC Option.

(33) Standardized Index Option — The term "standardized index option" means any options contract issued, or subject to issuance, by The Options Clearing Corporation that is based upon an index and is not an OCC Cleared OTC Option.

(34) The Options Clearing Corporation — The term "The Options Clearing Corporation" means The Options Clearing Corporation.

(35) Type of Option — The term "type of option" means the classification of an option contract as either a put or a call.

(36) Uncovered — The term "uncovered" in respect of a short position in an option contract means the short position is not covered. For purposes of paragraph (b)(16) (Opening of Accounts), paragraph (b)(20) (Supervision of Accounts) and paragraph (b)(11) (Delivery of Current Disclosure Document(s)), the term "writing uncovered short option positions" shall include combinations and any other transactions which involve uncovered writing.

(37) Underlying Index — The term "underlying index" means an index underlying a Standardized Index Option or a Conventional Index Option.

(38) Underlying Security — The term "underlying security" in respect of an option contract means the security which The Options Clearing Corporation or another person shall be obligated to sell (in the case of a call) or purchase (in the case of a put) upon the valid exercise of such option contract.

(39) Unit — The term "unit" shall mean the smallest interest in a particular security which can be purchased or sold, such as one share of stock, one warrant, one bond, and so forth.

## **(b) Requirements**

## **(1) Applicability**

This Rule shall be applicable to the extent appropriate unless otherwise stated herein: (A) to the conduct of accounts, the execution of transactions, and the handling of orders in exchange-listed options by members that are not members of an exchange on which the option executed is listed; (B) to the conduct of accounts, the execution of transactions, and the handling of orders in conventional options by all members; and (C) to other matters related to options trading.

Subparagraphs (3) through (12) shall apply only to standardized and conventional options on common stock. Subparagraphs (13) through (24) shall apply to transactions in all options as defined in paragraph (a)(21), including common stock unless otherwise indicated herein.

## **(2) FLEX Equity Options**

The position and exercise limits for FLEX Equity Options for members that are not also members of the exchange on which FLEX Equity Options trade shall be the same as the position and exercise limits as applicable to members of the exchange on which such FLEX Equity Options are traded.

## **(3) Position Limits**

### **(A) Stock Options —**

#### **(i) Standardized Equity Options**

Except in highly unusual circumstances, and with the prior written approval of FINRA pursuant to the [Rule 9600](#) Series for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, non-member broker, or non-member dealer, an opening transaction on any exchange in a stock option contract of any class of stock options if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or customer, non-member broker, or non-member dealer, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate standardized equity options position in excess of the highest position limit established by an exchange on which the option trades, or such other number of stock option contracts as may be fixed from time to time by FINRA as the position limit for one or more classes or series of options provided that reasonable notice shall be given of each new position limit fixed by FINRA.

#### **(ii) Equity Option Hedge Exemptions**

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a. The following qualified hedge strategies and positions described in subparagraphs 1. through 6. below shall be exempt from the established position limits under this Rule for standardized options. Hedge strategies and positions described in subparagraphs 7. and 8. below in which one of the option components consists of a conventional option, shall be subject to a position limit of five times the established position limits contained in paragraphs (b)(3)(A)(iii)a.1. through 6. below. Hedge strategies and positions in conventional options as described in subparagraphs 1. through 6. below shall be subject to a position limit of five times the established position limits contained in paragraphs (b)(3)(A)(iii)a.1. through 6. below. Options positions limits established under this subparagraph shall be separate from limits established in other provisions of this Rule.

1. Where each option contract is "hedged" or "covered" by 100 shares of the underlying security or securities convertible into the underlying security, or, in the case of an adjusted option, the same number of shares represented by the adjusted contract: (a) long call and short stock; (b) short call and long stock; (c) long put and long stock; or (d) short put and short stock.

2. Reverse Conversions — A long call position accompanied by a short put position, where the long call expires with the short put, and the strike price of the long call and short put is equal, and where each long call and short put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying security.

3. Conversions — A short call position accompanied by a long put position where the short call expires with the long put, and the strike price of the short call and long put is equal, and where each short call and long put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying security.

4. Reverse Collars — A long call position accompanied by a short put position where the long call expires with the short put and the strike price of the long call equals or exceeds the short put and where each long call and short put position is hedged with 100 shares of the underlying security (or other adjusted number of shares). Neither side of the long call, short put position can be in-the-money at the time the position is established.

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5. Collars — A short call position accompanied by a long put position, where the short call expires with the long put, and the strike price of the short call equals or exceeds the strike price of the long put position and where each short call and long put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying security. Neither side of the short call/long put position can be in-the-money at the time the position is established.

6. Box Spreads — A long call position accompanied by a short put position with the same strike price and a short call position accompanied by a long put position with a different strike price.

7. Back-to-Back Options — A listed option position hedged on a one-for-one basis with an over-the-counter (OTC) option position on the same underlying security. The strike price of the listed option position and corresponding OTC option position must be within one strike price interval of each other and no more than one expiration month apart.

8. For reverse conversion, conversion, reverse collar and collar strategies set forth above in subparagraphs 2., 3., 4. and 5., one of the option components can be an OTC option guaranteed or endorsed by the firm maintaining the proprietary position or carrying the customer account.

#### b. Delta Hedging Exemption For Members and Non- Member Affiliates

An equity options position of a member or non-member affiliate in standardized and/or conventional equity options that is delta neutral under a Permitted Pricing Model shall be exempt from position limits under this Rule. Any equity options position of such member or non-member affiliate that is not delta neutral shall be subject to position limits, subject to the availability of other options position limit exemptions. The number of options contracts attributable to a position that is not delta neutral shall be the options contract equivalent of the net delta.

##### 1. Permitted Pricing Model shall mean:

A. A pricing model maintained and operated by the Options Clearing Corporation ("OCC Model") when used by a member, or non-member affiliate permitted to rely on subparagraphs B or C;

B. A pricing model maintained and used by a member subject to consolidated supervision by the SEC pursuant to Appendix E of

SEA Rule 15c3-1, or by an affiliate that is part of such member's consolidated supervised holding company group, in accordance with its internal risk management control system and consistent with the requirements of Appendices E or G, as applicable, to SEA Rule 15c3-1 and SEA Rule 15c3-4, as amended from time to time, in connection with the calculation of risk-based deductions from capital or capital allowances for market risk thereunder, provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such member's consolidated supervised holding company group;

C. A pricing model maintained and used by a financial holding company ("FHC") or a company treated as an FHC under the Bank Holding Company Act, or by an affiliate that is part of either such company's consolidated supervised holding company group, in accordance with its internal risk management control system and consistent with:

i. the requirements of the Board of Governors of the Federal Reserve System, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Board of Governors of the Federal Reserve System, provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such company's consolidated supervised holding company group; or

ii. the standards published by the Basel Committee on Banking Supervision, as amended from time to time and as implemented by such company's principal regulator, in connection with the calculation of risk-based deductions or adjustments to or allowances for the market risk capital requirements of such principal regulator applicable to such company – where "principal regulator" means a member of the Basel Committee on Banking Supervision that is the home country consolidated supervisor of such company – provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such company's consolidated supervised holding company group;

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D. A pricing model maintained and used by an OTC derivatives dealer registered with the SEC pursuant to SEA Rule 15c3-1(a)(5) in accordance with its internal risk management control system and consistent with the requirements of Appendix F to SEA Rule 15c3-1 and SEA Rule 15c3-4, as amended from time to time, in connection with the calculation of risk-based deductions from capital for market risk thereunder, provided that only such OTC derivatives dealer and no other affiliated entity (including a member) may rely on this subparagraph D; or

E. A pricing model used by a national bank under the National Bank Act maintained and used in accordance with its internal risk management control system and consistent with the requirements of the Office of the Comptroller of the Currency, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Office of the Comptroller of the Currency, provided that only such national bank and no other affiliated entity (including a member) may rely on this exemption.

## 2. Effect on Aggregation of Account Positions

A. Members and non-member affiliates who rely on this exemption must ensure that the Permitted Pricing Model is applied to all positions in or relating to the security underlying the relevant options position that are owned or controlled by such member or non-member affiliate.

B. Notwithstanding subparagraph b.2.A. of this Rule, the Net Delta of an options position held by an entity entitled to rely on this exemption, or by a separate and distinct trading unit of such entity, may be calculated without regard to positions in or relating to the security underlying the options positions held by an affiliated entity or by another trading unit within the same entity, provided that:

i. the entity demonstrates to FINRA's satisfaction that no control relationship, as discussed in Supplementary Material .02, exists between such affiliates or trading units; and

ii. the entity has provided FINRA written notice in advance that it intends to be considered separate and distinct from any affiliate, or — as applicable — which trading units

within the entity are to be considered separate and distinct from each other for purposes of this exemption.

C. Notwithstanding subparagraph b.2.A. or b.2.B. of this Rule, a member or non-member affiliate who relies on this exemption shall designate, by prior written notice to FINRA, each trading unit or entity whose options positions are required under FINRA rules to be aggregated with the option positions of such member or non-member affiliate that is relying on this exemption for purposes of compliance with FINRA position limits or exercise limits. In any such case:

i. the Permitted Pricing Model shall be applied, for purposes of calculating such member's or affiliate's net delta, only to the positions in or relating to the security underlying any relevant option position owned and controlled by those entities and trading units who are relying on this exemption; and

ii. the net delta of the positions owned or controlled by the entities and trading units who are relying on this exemption shall be aggregated with the nonexempt option positions of all other entities and trading units whose options positions are required under FINRA rules to be aggregated with the option positions of such member or affiliate.

### 3. Obligations of Members and Affiliates

A member that relies, or whose affiliate relies, upon this exemption must provide a written certification to FINRA that it and/or its affiliates are using a Permitted Pricing Model pursuant to subparagraph 1. above and that if the affiliate ceases to hedge stock options positions in accordance with such Permitted Pricing Model, it will provide immediate written notice to the member.

The options positions of a non-member relying on this exemption must be carried by a member with which it is affiliated.

### 4. Reporting

A. Each member must report in accordance with paragraph (b) (5), all equity option positions (including those that are delta neutral) of 200 or more contracts (whether long or short) on the same side of

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the market covering the same underlying security that are effected by the member.

B. In addition, each member on its own behalf or on behalf of a designated aggregation unit pursuant to paragraph (b)(3)(A)(ii)b.2. shall report in a manner specified by FINRA the options contract equivalent of the net delta of each position that represents 200 or more contracts (whether long or short) on the same side of the market covering the same underlying security that are effected by the member.

### (iii) Conventional Equity Options

a. For purposes of this paragraph (b), standardized equity option contracts of the put class and call class on the same side of the market overlying the same security shall not be aggregated with conventional equity option contracts or FLEX Equity Option contracts overlying the same security on the same side of the market. Conventional equity option contracts of the put class and call class on the same side of the market overlying the same security shall be subject to a position limit of:

1. 25,000 option contracts, combining for purposes of this position limit long positions in put options with short positions in call options, and short positions in put options with long positions in call options; or

2. 50,000 option contracts for option contracts on securities that underlie exchange-traded options qualifying under applicable rules for a position limit of 50,000 option contracts; or

3. 75,000 option contracts for option contracts on securities that underlie exchange-traded options qualifying under applicable rules for a position limit of 75,000 option contracts; or

4. 200,000 option contracts for option contracts on securities that underlie exchange-traded options qualifying under applicable rules for a position limit of 200,000 option contracts; or

5. 250,000 option contracts for option contracts on securities that underlie exchange-traded options qualifying under applicable rules for a position limit of 250,000 option contracts; or

6. for selected conventional options on exchange-traded funds ("ETF"), the position limits are listed in the chart below:



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<b>Security Underlying Option</b>	<b>Position Limit</b>
The DIAMONDS Trust (DIA)	300,000 contracts
The Standard and Poor's Depository Receipts Trust (SPY)	3,600,000 contracts
The iShares Russell 2000 ETF (IWM)	1,000,000 contracts
The PowerShares QQQ Trust (QQQ)	1,800,000 contracts
The iShares MSCI Emerging Markets ETF (EEM)	1,000,000 contracts
iShares China Large-Cap ETF (FXI)	1,000,000 contracts
iShares MSCI EAFE ETF (EFA)	1,000,000 contracts
iShares MSCI Brazil Capped ETF (EWZ)	500,000 contracts
iShares 20+ Year Treasury Bond Fund ETF (TLT)	500,000 contracts
iShares MSCI Japan ETF (EWJ)	500,000 contracts
iShares iBoxx High Yield Corporate Bond Fund (HYG)	500,000 contracts
iShares iBoxx \$ Investment Grade Corporate Bond ETF (LQD)	500,000 contracts
Financial Select Sector SPDR Fund (XLF)	500,000 contracts
VanEck Vectors Gold Miners ETF (GDX)	500,000 contracts

b. In order for a security not subject to standardized equity options trading to qualify for an options position limit of more than 25,000 contracts, a member

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must first demonstrate to FINRA's Market Regulation Department that the underlying security meets the standards for such higher options position limit and the initial listing standards for standardized options trading.

Provided, however, that for certain securities in an index designated by FINRA, a member may claim such higher position limit as permitted in accordance with the volume and float criteria specified by FINRA; provided further, that a member claiming a higher position limit under this subparagraph must notify FINRA's Market Regulation Department in writing in such form as may be prescribed by FINRA and shall be filed no later than the close of business day on the next business day following the day on which the transaction or transactions requiring such limits occurred; and provided further, that the member must agree to reduce its position in the event that FINRA staff determines different position limits shall apply.

#### (B) Index Options

Except in highly unusual circumstances, and with the prior written approval of FINRA pursuant to the [Rule 9600 Series](#) for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, an opening transaction in an option contract of any class of index options dealt in on an exchange if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or customer, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate position in excess of position limits established by the exchange on which the option trades.

(C) Index option contracts shall not be aggregated with option contracts on any stocks whose prices are the basis for calculation of the index.

(D) FINRA will notify the SEC at any time it approves a request to exceed the limits established pursuant to paragraph (b)(3).

#### (4) Exercise Limits

Except in highly unusual circumstances, and with the prior written approval of FINRA pursuant to the [Rule 9600 Series](#) for good cause shown in each instance, no member or person associated with a member shall exercise, for any account in which such member or person associated with a member has an interest, or for the account of any partner, officer, director or employee thereof or for the account of any customer, non-member broker, or non-member dealer, any option contract if as a result thereof such member or partner, officer, director or employee thereof or customer, non-member broker, or non-member dealer, acting alone or in