

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71143)

December 19, 2013

Order Granting Application by Financial Industry Regulatory Authority, Inc. for Exemption Pursuant to Section 36(a) of the Exchange Act from the Rule Filing Requirements of Section 19(b) of the Exchange Act with Respect to Certain Rules Incorporated by Reference

The Financial Industry Regulatory Authority, Inc. (“FINRA”) has filed with the Securities and Exchange Commission (“Commission”) an application for an exemption under Section 36(a)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ from the rule filing requirements of Section 19(b) of the Exchange Act² with respect to certain rules of other self-regulatory organizations (“SROs”) that FINRA seeks to incorporate by reference. Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class thereof, from any provision of the Exchange Act or rule thereunder, if necessary or appropriate in the public interest and consistent with the protection of investors.

FINRA Rule 2360 (Options) and FINRA Rule 2359 (Position and Exercise Limits; Liquidations) incorporate by reference comparable position and exercise limit rules of the options exchanges. Specifically: (i) FINRA Rule 2360(b)(3)(B) incorporates position limits for index options established by the exchange on which the option trades; (ii) FINRA Rule 2360(b)(2) incorporates position and exercise limits for FLEX Equity Options (as defined in FINRA Rule 2360(a)(16)) established by the exchange on which such FLEX Equity Options are traded; and (iii) FINRA Rule 2359 incorporates position and exercise limits for index warrants

¹ 15 U.S.C. 78mm(a)(1).

² 15 U.S.C. 78s(b).

established by the exchange on which the index warrant is listed.³ Thus, FINRA members comply with these FINRA rules by complying with the relevant, incorporated exchange rule.⁴

In addition, if its request for an exemption is granted, FINRA intends to propose further amendments to FINRA Rule 2360, pursuant to Section 19(b)(1) of the Exchange Act, to incorporate by reference other rules of the options exchanges regarding position limits. Specifically, with respect to standardized equity options, FINRA intends to propose that FINRA Rule 2360(b)(3) be amended so that the FINRA position limit will be the highest position limit established by an exchange on which the option trades.⁵ With respect to conventional equity options,⁶ FINRA intends to propose that FINRA Rule 2360(b)(3) be amended so that the position limit tiers for such options reflect the same tier structure used in exchange rules for standardized equity options and, for each tier, incorporate for conventional equity options the same position limit that exchange rules establish for standardized equity options in the equivalent tier.⁷ In addition, FINRA Rule 2360(b)(4) sets forth exercise limits by referring to the position

³ See FINRA Rules 2359 and 2360; see also Letter from Robert L.D. Colby, Chief Legal Officer, FINRA, to Elizabeth M. Murphy, Secretary, Commission, dated October 10, 2013 (“FINRA Exemptive Request”), at 1 n.1.

⁴ FINRA has not previously sought an exemption from the Commission pursuant to Section 36(a)(1) of the Exchange Act from the rule filing requirements of Section 19(b) of the Exchange Act with respect to these incorporations by reference.

⁵ See FINRA Exemptive Request, supra note 3, at 1 n.2. Based on the standardized equity option position limits currently imposed by the option exchanges, this incorporation by reference would have the immediate effect of eliminating FINRA’s position limit for standardized options on Standard and Poor’s Depository Receipts Trust (“SPY”) and increasing FINRA’s position limit for standardized options on the iShares MSCI Emerging Markets Index Fund (“EEM”) to 500,000 contracts.

⁶ The term “conventional option” means any option contract not issued, or subject to issuance, by the Options Clearing Corporation. See FINRA Rule 2360(a)(9).

⁷ See FINRA Exemptive Request, supra note 3, at 1 n.2. This aspect of FINRA’s intended proposal would not change position limits for conventional equity options, as FINRA’s rule currently imposes conventional equity option position limits that are the same as the tiered limits for standardized equity options set forth in FINRA Rule 2360(b)(3)(A)(ii)

limits in FINRA Rule 2360(b)(3).⁸ Accordingly, FINRA's anticipated proposed rule change also would correspondingly raise exercise limits.⁹

FINRA has requested, pursuant to Rule 0-12 under the Exchange Act,¹⁰ that the Commission grant it an exemption from the rule filing requirements of Section 19(b) of the Exchange Act for changes to FINRA Rule 2359 and FINRA Rule 2360, as amended by FINRA's intended proposal, that are effected solely by virtue of a change to the corresponding cross-referenced rules of the options exchanges. Specifically, FINRA requests that it be permitted to incorporate by reference changes made to each such options exchange rule without the need for FINRA to file separately the same proposed rule changes pursuant to Section 19(b) of the Exchange Act.¹¹ By virtue of these incorporations by reference, the requirements applicable to FINRA members will change when the applicable incorporated exchanges' rules change, without the need for FINRA to file separately the proposed rule changes pursuant to Section 19(b) of the Exchange Act.¹² FINRA represents that the rules it seeks to incorporate by reference into FINRA Rules 2359 and 2360 are categories of exchange rules (rather than individual rules within a category) that are not trading rules.¹³ FINRA has agreed to provide written notice to its

through (v) for which the underlying security qualifies or would be able to qualify. See FINRA Rule 2360(b)(3)(A)(viii). Currently, FINRA Rule 2360(b)(3)(A)(viii) cross references FINRA Rule 2360(b)(3)(A)(ii) through (v) instead of reproducing the language of those paragraphs setting forth the position limit tiers. This aspect of FINRA's intended proposal would amend FINRA's conventional equity option position limit rule to replace that cross reference with the actual language setting forth the position limit tiers.

⁸ See FINRA Exemptive Request, supra note 3, at 1 n.2.

⁹ Id.

¹⁰ 17 CFR 240.0-12.

¹¹ See FINRA Exemptive Request, supra note 3, at 2.

¹² Id.

¹³ Id.

members whenever an exchange proposes a change to its relevant, cross-referenced rule (or series of rules).¹⁴

FINRA believes this exemption is necessary and appropriate to maintain the consistency between FINRA rules and the relevant provisions of the exchanges' rules at all times, thus helping to ensure identical regulation of members of FINRA that are also members of one or more exchanges with respect to the incorporated provisions, as well as helping to ensure that FINRA-only members are subject to consistent regulation as members that are members of exchanges.¹⁵ Without such an exemption, such members could be subject to two different standards.¹⁶

The Commission has issued exemptions to other exchanges similar to FINRA's request.¹⁷ In granting one such exemption in 2010, the Commission repeated a prior, 2004 Commission statement that it would consider similar future exemption requests from other SROs, provided that:

¹⁴ Id. at 3. FINRA states that it will provide such notice on its website where it posts its own proposed rule change filings as required by Rule 19b-4(l). In addition, FINRA states that the website posting will include a link to the location on the exchange's website where the proposed rule change is posted. Id. at 3 n.8.

¹⁵ Id. at 2-3.

¹⁶ Id. at 3.

¹⁷ For example, on behalf of their respective options markets, BATS Exchange, Inc., NASDAQ OMX BX, Inc., and The NASDAQ Stock Market LLC incorporate, among other things, the position limit rules of other exchanges. See, e.g., Securities Exchange Act Release No. 61534 (February 18, 2010), 75 FR 8760 (February 25, 2010) (order granting BATS Exchange, Inc. exemptive request relating to rules incorporated by reference by the BATS Exchange Options Market rules) ("BATS Options Market Order"); Securities Exchange Act Release No. 67256 (June 26, 2012), 77 FR 39277, 39286 (July 2, 2012) (order approving SR-BX-2012-030 and granting exemptive request relating to rules incorporated by reference by the BX Options rules); Securities Exchange Act Release No. 57478 (March 12, 2008), 73 FR 14521, 14539-40 (March 18, 2008) (order approving SR-NASDAQ-2007-004 and SR-NASDAQ-2007-080, and granting exemptive request relating to rules incorporated by reference by The NASDAQ Options Market).

- An SRO wishing to incorporate rules of another SRO by reference has submitted a written request for an order exempting it from the requirement in Section 19(b) of the Exchange Act to file proposed rule changes relating to the rules incorporated by reference, has identified the applicable originating SRO(s), together with the rules it wants to incorporate by reference, and otherwise has complied with the procedural requirements set forth in the Commission’s release governing procedures for requesting exemptive orders pursuant to Rule 0-12 under the Exchange Act;¹⁸
- An incorporating SRO has requested incorporation of categories of rules (rather than individual rules within a category) that are not trading rules (e.g., the SRO has requested incorporation of rules such as margin, suitability, or arbitration); and
- The incorporating SRO has reasonable procedures in place to provide written notice to its members each time a change is proposed to the incorporated rules of another SRO.¹⁹

The Commission believes that FINRA has satisfied each of these conditions. The Commission also believes that granting FINRA an exemption from the rule filing requirements under Section 19(b) of the Exchange Act will promote efficient use of Commission and FINRA resources by avoiding duplicative rule filings based on simultaneous changes to identical rule text sought by more than one SRO.²⁰ The Commission therefore finds it appropriate in the public interest and consistent with the protection of investors to exempt FINRA from the rule

¹⁸ See 17 CFR 240.0-12 and Securities Exchange Act Release No. 39624 (February 5, 1998), 63 FR 8101 (February 18, 1998) (Commission Procedures for Filing Applications for Orders for Exemptive Relief Pursuant to Section 36 of the Exchange Act; Final Rule).

¹⁹ See BATS Options Market Order, *supra* note 17 (citing Securities Exchange Act Release No. 49260 (February 17, 2004), 69 FR 8500 (February 24, 2004) (order granting exemptive request relating to rules incorporated by reference by several SROs) (“2004 Order”).

²⁰ See BATS Options Market Order, *supra* note 17, 75 FR at 8761; see also 2004 Order, *supra* note 19, 69 FR at 8502.

filing requirements under Section 19(b) of the Exchange Act with respect to the above-described rules it has incorporated, and intends to incorporate, by reference. This exemption is conditioned upon FINRA promptly providing written notice to its members whenever an exchange changes a rule that FINRA has incorporated by reference.

Accordingly, IT IS ORDERED, pursuant to Section 36 of the Exchange Act,²¹ that FINRA is exempt from the rule filing requirements of Section 19(b) of the Exchange Act solely with respect to changes to the rules identified in its request that incorporate by reference certain rules of the options exchanges,²² provided that FINRA promptly provides written notice to its members whenever an exchange proposes to change a rule that FINRA has incorporated by reference.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²³

Kevin M. O'Neill
Deputy Secretary

²¹ 15 U.S.C. 78mm.

²² See supra notes 3 through 9, and accompanying text.

²³ 17 CFR 200.30-3(a)(76).