Equities 14.00

Introduction

The following section of the compliance and supervisory procedure manual applies to broker/dealers conducting business in NASDAQ and over-the-counter (OTC) securities.

14.01 Prompt Receipt and Delivery of Securities

The Firm has implemented an internal policy to ensure the prompt receipt and delivery of all securities in accordance with FINRA Rule 11860 (formally NASD Rule 3370).

Purchase and Delivery of Securities

No member shall accept an order from a customer, including foreign customers and/or broker-dealers trading with or through the member, for eligible transactions of such customers that settle in the United States, pursuant to an arrangement whereby payment for securities purchased or delivery of securities sold is to be made to or by an agent of the customer unless all of the following procedures are followed:

1. The member shall have received from the customer prior to or at the time of accepting the order, the name and address of the agent and the time and account number of the customer on file with the agent and institution number, where appropriate.

2. Each order accepted from the customer pursuant to such an arrangement has noted thereon the fact that it is a payment on delivery (POD) or collect on delivery (COD) transaction.

3. The member shall deliver to the customer a confirmation, or all relevant data customarily contained in a confirmation with respect to the execution of the order, in whole or in part, not later than the close of business on the next business day after any such execution.

4. The member shall have obtained an agreement from the customer that the customer will furnish its agent instructions with respect to the receipt or delivery of the securities involved in the transaction promptly upon receipt by the customer of each confirmation, or the relevant data as to each execution, relating to such order (even though such execution represents the purchase or sale of only a part of the order), and that in any event the customer will assure that such instructions are delivered to its agent no later than: (i) in the case of a purchase by the customer where the agent is to receive the securities against payment (COD), the close of business on the second business day after the date of execution of the trade as to which the particular confirmation relates; or (ii) in the case of a sale by the customer where the agent is to deliver the securities against payment (POD), the close of business on the first business day after the date of execution of the trade as to which the particular confirmation relates.

5. The facilities of a Clearing Agency shall be utilized for the book-entry settlement of all depository eligible transactions except transactions that are to be settled outside the United States. The facilities of either a Clearing Agency or a Qualified Vendor shall be utilized for the electronic confirmation and affirmation of all depository eligible transactions.

Securities Sales

Long Sales

No member or persons associated with a member shall accept a long sale order from any customer in any security (except exempt securities other than municipals) unless:

- The Firm has possession of the security ;
- The customer is long in his account with the member ;
- The Firm or person associated with the Firm makes an affirmative determination that the customer owns the security and will deliver it in good deliverable form within three (3) business days of the execution of the order; or
- The security is on deposit in good deliverable form with a FINRA broker/dealer, a member of a national securities exchange, a broker/dealer registered with the SEC, or any organization subject to state or federal banking regulations and that instructions have been forwarded to that depository to deliver the securities against payment

Short Sales

On July 20, 2010, the SEC approved a FINRA proposed rule change to adopt Rule 3210, with minor changes, as FINRA Rule 4320 in the Consolidated FINRA Rulebook. FINRA Rule 4320 applies short sale delivery requirements to equity securities not otherwise covered by the close-out requirements of Regulation SHO. Among other things, FINRA Rule 4320 requires participants of registered clearing agencies to take action on failures to deliver that exist for 13 consecutive settlement days in certain non-reporting securities. In addition, if the fail to deliver position is not closed out in the requisite time period, a participant of a registered clearing agency or any broker/dealer for which it clears transactions is prohibited from effecting further short sales in the particular specified security without borrowing, or entering into a bona fide arrangement to borrow, the security until the fail to deliver position is closed out.

With a few exceptions, new FINRA Rule 4320 is identical to former NASD Rule 3210, and the changes made to the text do not alter the operation and application of the rule. For example, the new FINRA rule omits language that provided allowances for ‘‘grandfathered’’ securities during the initial implementation period of NASD Rule 3210 which no longer is relevant. In addition, FINRA Rule 4320 clarifies, consistent with Regulation SHO, the borrowing requirements for clearing agency participants— including broker-dealers for which they clear transactions—that sell short non-reporting threshold securities for which a fail to deliver position has not been closed out in the requisite time.

Customer Short Sales

The Firm shall not accept a “short” sale order for any customer in any security unless the Firm or person associated with the Firm makes an affirmative determination that the member will receive delivery of the security from the customer or that the member can borrow the security on behalf of the customer for delivery by settlement date. This requirement shall not apply, however, to transactions in corporate debt securities.

Proprietary Short Sales

The Firm shall not effect a “short” sale for its own account in any security unless the Firm makes an affirmative determination that the Firm can borrow the securities or otherwise provide for delivery of the securities by the settlement date.

Note: This requirement will not apply to transactions in corporate debt securities, to bona fide market making transactions by a FINRA broker/dealer in securities in which it is registered as a Nasdaq market maker, to bona fide market maker transactions in non-Nasdaq securities in which the market maker publishes a two-sided quotation in an independent quotation medium, or to transactions which result in fully hedged or arbitraged positions.

Affirmative Determination

Long Sales

To satisfy the requirements for an affirmative determination for long sales, the Firm must make a notation on the order ticket at the time the order is taken which reflects the conversation with the customer as to the present location of the securities in question, whether they are in good deliverable form and the customer's ability to deliver them to the member within three (3) business days.

Short Sales

To satisfy the requirement for an affirmative determination for customer and proprietary short sales, the Firm must keep a written record which includes:

- If a customer assures delivery, the present location of the securities in question, whether they are in good deliverable form and the customer's ability to deliver them to the Firm within three (3) business days; or

- If the Firm locates the stock, the identity of the individual and firm contacted who offered assurance that the shares would be delivered or that were available for borrowing by settlement date and the number of shares needed to cover the short sale;

The Firm may rely on "blanket" or standing assurances (*i.e.,* "Easy to Borrow" lists) that securities will be available for borrowing on settlement date to satisfy their affirmative determination requirements under this Rule.

For any short sales executed in Nasdaq National Market (NNM) or national securities exchange-listed (listed) securities, the Firm may rely on "Hard to Borrow" lists indicating NNM or listed securities that are difficult to borrow or unavailable for borrowing on settlement date to satisfy their affirmative determination requirements under *Rule 3370*, provided that:

- Any securities restricted pursuant to *UPC 11830* must be included on such a list;

- The creator of the list attests in writing on the document or otherwise that any NNM or listed securities not included on the list are easy to borrow or are available for borrowing.

The Firm is permitted to use Easy to Borrow or Hard to Borrow lists under the following conditions:

- The information used to generate the list is less than 24-hours old;

- The member delivers the security on settlement date.

Note: "Hard to Borrow" lists only apply to NASDAQ National Market or exchange-listed securities. They do not apply to OTCBB and NASDAQ Small Cap securities. Broker/dealers must maintain a list of ALL securities that are AVAILABLE to be borrowed in OTCBB and NASDAQ Small Cap securities.

Note: The Firm currently does not allow short sales.

14.02 Order Ticket Review

The designated principal should review a representative sample of the Firm's equities order tickets periodically to verify that all of the information is complete and accurate. ►►

Implementation Strategy

The designated principal shall conduct a periodic review of customer order tickets to verify that all order ticket information is complete and accurate. The designated supervisor shall confirm the review of such order tickets by initialing all batched records as evidence of review.

14.03 Customer Confirmation Review

The designated principal of the Firm should periodically review a representative sample of the Firm's equities trade confirmations to verify that all of the information is complete and accurate.

Extension of Temporary Relief from NYSE Rule 409(f) (Statements of Accounts to Customers)

NYSE Rule 409(f) requires that confirmations of all transactions (including those made "over-the-counter" and on other exchanges) in securities admitted to dealings on the NYSE, sent by FINRA members that are also members of NYSE (Dual Members) to their customers, shall indicate the settlement date of the transaction and the name of the securities market on which the transaction was effected. This requirement also applies to confirmations or reports from a Dual Member to a correspondent, but does not apply to reports made by floor brokers to the Dual Member from which the orders were received.

With the adoption of Regulation NMS (Reg NMS), an increasing number of orders routed to a given market for execution are rerouted to other markets which at that time display a better quotation. This process, required under the Reg NMS Order Protection Rule, may often lead to relatively small orders receiving executions in multiple market centers. This has created an operational challenge for Dual Members to capture the name of the market of execution on a timely basis for inclusion on the transaction confirmation.

As a result of these challenges, and given that Reg NMS requires Dual Members to comply with their "best execution" obligations to exercise diligence to obtain the best price when routing customer trades for execution, the relief from the application of NYSE Rule 409(f), with respect to the name of the market of execution, is extended until January 1, 2008. (Ref. Regulatory Notice 07-35; Issued Aug. 10, 2007)►►

Implementation Strategy

The designated principal shall conduct a periodic review of trade confirmations to verify that all information is complete and accurate in comparison to their corresponding orders. The designated supervisor shall initial all batched records as evidence of review.

14.04 Customer Account Review

The Firm should conduct a periodic review of all customer accounts that engage in equities transactions to determine if there are any unusual trading patters or indications of sales practice abuses. ►►

Implementation Strategy

The designated principal shall review daily blotters and exception reports to detect any unusual trading patterns or indications of sales practice violations. Additionally, the designated supervisor shall confirm the review of such accounts by initialing reviewed docs and/or reports as evidence of review.

14.05 Clearing Agreements and the Clearing Firm

The introducing firm is required to maintain a current copy of its clearing agreement. Additionally the Firm should also contact its clearing firm to obtain and verify the following information:

- The Firm should contact its clearing firm at least annually and obtain a list of all compliance and exception reports that the clearing firm offers its correspondents;
- The introducing firm should verify that the clearing firm is reporting all of its CAT information correctly (The Firm is in Phase 3 and is currently not reporting);
- The introducing firm should verify that the clearing firm is reporting all of the introducing firm's trades correctly;
- The introducing firm should verify that the clearing firm is making all appropriate payment for order flow disclosures to customers annually; and
- The introducing firm should attempt to verify that all limit orders forwarded on to other broker/dealers are handled correctly. ►►

> **Implementation Strategy**
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> On an as needed basis, the designated principal will verify that the clearing firm (NFS) is accurately reporting all of the information as described above. When necessary, all amendments to the clearing agreement will be reviewed and filed accordingly.

14.06 Fair Prices and Commissions

Principal Transactions

In accordance with *Rule 2440*, in the event that Firm buys from a customer or sells to a customer listed or unlisted OTC transactions from its own account, the Firm will ensure that it buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit.

Agency Transactions

In the event that Firm acts as agent for its customer(s) in any such transaction, the Firm shall not charge its customer(s) more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market.

Mark-up Policy ("5% Policy")

It shall be deemed a violation of FINRA Rule 2010 (formally NASD Rule 2110) and FINRA Rule *2440* for a broker/dealer to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission which is not reasonable. With the adoption of the "5% Policy," the following details shall apply:

- The "5% Policy" is a guide, not a rule;
- A firm may not justify mark-ups on the basis of expenses which are excessive;
- The mark-up over the prevailing market price is the significant spread from the point of view of fairness of dealings with customers in principal transactions. In the absence of

other bona fide evidence of the prevailing market, a firm's own contemporaneous cost is the best indication of the prevailing market price of a security;

- A mark-up pattern of 5% or even less may be considered unfair or unreasonable under the "5% Policy;"

- Determination of the fairness of mark-ups must be based on a consideration of all the relevant factors, of which the percentage of markup is only one.

Relevant Factors

The Firm should take into consideration the following factors in determining the fairness of a mark-up:

- The Type of Security Involved- some securities customarily carry a higher mark-up than others. For example, a higher percentage of mark-up customarily applies to a common stock transaction than to a bond transaction of the same size. Likewise, a higher percentage applies to sales of units of direct participation programs and condominium securities than to sales of common stock;

- The Availability of the Security in the Market- in the case of an inactive security the effort and cost of buying or selling the security, or any other unusual circumstances connected with its acquisition or sale, may have a bearing on the amount of mark-up justified;

- The Price of the Security- while there is no direct correlation, the percentage of mark-up or rate of commission generally increases as the price of the security decreases. Even where the amount of money is substantial, transactions in lower priced securities may require more handling and expense and may warrant a wider spread;

- The Amount of Money Involved in a Transaction- a transaction which involves a small amount of money may warrant a higher percentage of mark-up to cover the expenses of handling;

- Disclosure- any disclosure to the customer, before the transaction is effected, of information which would indicate (1) the amount of commission charged in an agency transaction or (2) mark-up made in a principal transaction is a factor to be considered. Disclosure itself, however, does not justify a commission or mark-up which is unfair or excessive in light of all other relevant circumstances;

- The Pattern of Mark-Ups- while each transaction must meet the test of fairness, particular attention should be given to the *pattern* of mark-ups;

- The Nature of the Firm's Business- there are certain differences in the services and facilities which are needed by, and provided for, customers of firms. If not excessive, the cost of providing such services and facilities, particularly when they are of a continuing nature, may properly be considered in determining the fairness of a firm's mark-ups.

Transactions to Which the Policy is Applicable

The "5% Policy" applies to all securities handled in the over-the-counter market in the following types of transactions:

- A transaction in which a member buys a security to fill an order for the same security previously received from a customer. This transaction would include the so-called “riskless” or “simultaneous” transaction;

- A transaction in which the member sells a security to a customer from inventory. In such a case the amount of the mark-up would be determined on the basis of the mark-up over the bona fide representative current market. The amount of profit or loss to the member from market appreciation or depreciation before, or after, the date of the transaction with the customer would not ordinarily enter into the determination of the amount or fairness of the mark-up;

- A transaction in which a broker/dealer purchases a security from a customer. The price paid to the customer or the mark-down applied by the broker/dealer must be reasonably related to the prevailing market price of the security;

- A transaction in which the broker/dealer acts as agent. In such a case, the commission charged the customer must be fair in light of all relevant circumstances;

- Transactions wherein a customer sells securities to, or through, a broker/dealer, the proceeds from which are utilized to pay for other securities purchased from, or through, the broker/dealer at or about the same time. In such instances, the mark-up shall be computed in the same way as if the customer had purchased for cash and in computing the mark-up there shall be included any profit or commission realized by the dealer on the securities being liquidated, the proceeds of which are used to pay for securities being purchased.

Transactions to Which the Policy is *Not Applicable*

The Mark-Up Policy does not apply to the sale of securities where a prospectus/offering circular is required to be delivered and the securities are sold at the specific public offering price. ►►

Implementation Strategy

On a monthly basis, the designated principal will conduct a review of the monthly commission reports to determine if the mark-ups and mark-downs charged to customers were fair and reasonable in accordance with Firm guidelines and FINRA rules and regulations. All relevant documents will be initialed as evidence of review.

14.07 Average Priced Trading

Occasionally, customers prefer to receive one confirmation representing an average price for multiple executions of the same security. *SEC Rule 10b-10* mandates that broker/dealers provide confirmations for each transaction; however, the SEC has stated that it would permit average pricing of multiple executions if certain conditions are met.

The trader confirming an average price is responsible for ensuring that all of the following information is provided to the customer:

- All transactions, not just agency crosses, in Nasdaq listed and exchange-listed securities that are traded on a weighted average basis or effected based on other special pricing formula, to be reported with the .W modifier;

- The execution prices of each individual execution that filled the order must be averaged and the average price reported as the unit price on the confirmation. The confirmation must

disclose that the price is an average price and that details regarding the actual process are available to the customer upon request;

- The confirmation must identify the capacity in which the Firm acted (principal; agent; or both principal and agent) and that details regarding the capacity of each execution fare available upon request; and

- The commission, markup, markdown, service charge, or other remuneration must be stated in a single amount for the transaction as a whole.

  Note: The trader's records must also include details of each execution comprising the average-priced transaction.

Volume-Weighted Average Price (VWAP) Transactions

In the event that the Firm executes a volume-weighted average price (VWAP) or other large, potentially market-moving transactions for a customer, the Firm must not engage in proprietary trading activity that compromises a customer's interest in favor of its own proprietary trading interest in accordance with just and equitable principles of trade under FINRA Rule 2010 (formally NASD Rule 2110), and a firm's best execution obligations pursuant to FINRA Rule 2320. Under such circumstances, the Firm has a duty to disclose in writing to the customer that the Firm may engage in hedging or other positioning activity that could affect the market for a security that is involved in the transaction. (NTM 05-51; Aug. 11, 2005) ►►

Implementation Strategy

When the Firm receives a customer's order, the Firm is obligated to: (1) refrain from any conduct that could disadvantage or harm the execution of a customer's order or place the Firm's financial interests ahead of those of its customer's, and (2) if applicable, disclose in writing to the customer that the Firm intends to engage in hedging and other positioning activity that could affect the market for the security that is the subject of the transaction, and consequently the cost or proceeds to the customer (collectively referred to as "the duty to refrain and disclose"). The disclosure will be made prior to receipt and/or execution of the order and be in the form of an affirmative consent letter that covers potential hedging and positioning transactions related to the handling of VWAP and other large orders. The Firm need not obtain affirmative consent on a transaction-by-transaction basis; however, such consent should occur at least annually to reaffirm their consent.

Marking of Orders

Depending on the terms and characteristics of an order, the designated principal will ensure that each VWAP order is properly classified as either long or short for purposes of order entry and reporting. Short sale orders must be executed in compliance with all applicable FINRA and SEC short sale rules and regulations. With respect to a VWAP, both the individual trades by the member to accommodate the VWAP and the aggregate VWAP trade itself are subject to those short sale rules and regulations. In the event that a member is short the securities underlying a VWAP sell order, the member's order(s) may need to be marked "short" (or "short exempt," if applicable), depending on the firm's (or aggregation unit's) overall position, even if the customer is long the subject securities.

Compensation

In the event that the Firm receives a VWAP or similar order, the Firm must disclose to the customer in writing the specifics of the terms of compensation it will receive to execute the order. Thus, for example, the Firm must disclose if intends to retain or split with the customer any profits that result if the member improves upon the VWAP.

The designated supervisor will conduct an evaluation of proprietary trading that took place in advance of the execution of VWAP orders. If applicable, the designated supervisor will reasonably ensure that customers affirmatively acknowledged the receipt of notice that the Firm may engage in hedging or other trading activity related to the execution of a customer's order.

All hedging or positioning trades will be reviewed by the designated supervisor prior to completing each trade. The designated supervisor will also review to ensure that, other than for the purpose of fulfilling the customer order, under no circumstances may the Firm trade for its proprietary account on the non-public information it receives from the current or prospective customer or communicate such non-public information to another entity or person outside of the Firm. In the event that suspicious activity is discovered (i.e. creating an artificial appearance of demand (supply) for the security or establishing artificially high (low) prices by engaging in unnecessary trading, increased quote activity, or entering orders around the close of when a VWAP or other large order is executed), the designated supervisor will promptly investigate the incident in an effort to resolve the matter. Any violations of Firm policies may result in disciplinary action.

14.08 Block Transactions

A "block transaction" is defined as 10,000 or more shares of a common security, or a quantity of any such security having a market value of $200,000 or more ("block size") that is traded on a qualified exchange. All appropriately licensed registered representatives of the Firm may engage in block transaction requests from customers as defined above. In order for block transactions to occur, the following conditions shall be met:

- Each registered representative who receives a block transactions shall obtain approval from a designated principal prior to conducting such transaction; and
- All block transaction requests from customers will be reviewed for suitability based on customer's investment experience, financial condition, and overall investment objectives. ►►

Implementation Strategy

The designated principal will review new account documents and trade orders for all block transactions for approval and processing. The designated principal will also document and record all block trade order ticket(s) and other relevant records as evidence of review.

14.09 Best Execution and Interpositioning

The Firm maintains a strict adherence to its responsibility to achieve best execution for its clients. In order to achieve this goal, in any transaction for or with a customer, or a customer of another broker/dealer (Ref. NTM 06-58; Effective Nov. 8, 2006), the Firm shall use reasonable diligence to ascertain the best inter-dealer market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.

FINRA Rule 5310 is the new consolidated rule governing members' best execution requirements and is based largely on NASD Rule 2320. The Supplementary Material to Rule 5310 draws substantially from NASD IM-2320 but includes several new provisions that are described below. Rule 6438 replaces, but does not substantively alter, NASD Rule 2320(f)(2) requiring members to display the same priced quotation for OTC equity securities in multiple quotation mediums.

"Reasonable Diligence" Standard

FINRA Rule 5310 leaves in place the general requirements of best execution. Rule 5310(a) requires a member firm, in any transaction for or with a customer or a customer of another broker-dealer, to use "reasonable diligence" to ascertain the best market for a security and to buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.

Among the factors that will be considered in determining whether a member has used “reasonable diligence” are:

- the character of the market for the security, e.g., price, volatility, relative liquidity, and pressure on available communications;
- the size and type of transaction;
- the number of primary markets checked;
- accessibility of the quotation; and
- the terms and conditions of the order which result in the transaction, as communicated to the firm and persons associated with the firm.

Rule 5310 also includes provisions related to interpositioning (*i.e.*, interjecting a third party between the firm and the best available market), the use of a broker’s broker, the staffing of order rooms and the application of the best execution requirements to other parties.

Execution of Customer Orders

FINRA requires executing broker/dealers to execute customer orders or executable limit orders in less than 60 seconds under normal market conditions. Unusual market conditions can include the market open, the resumption of trading after a market halt, or any other unusual situation that disrupts normal trading activity. However, executing broker/dealers must realize that even 60 seconds may be considered too long to execute a marketable order. Therefore, all executing broker/dealers firms should establish and enforce written supervisory procedures to ensure a regular and rigorous examination of all available markets to ensure that all customers receive best execution.

Interpositioning

In any transaction for or with a customer, the Firm will not interject a third party between the member and the best available market except in cases where the Firm can demonstrate that to its knowledge at the time of the transaction the total cost or proceeds of the transaction, as confirmed to the Firm while acting for or with the customer, was better than the prevailing inter-dealer market for the security.

In the event the Firm cannot execute directly with a market maker but must employ a broker’s broker or some other means in order to insure an execution advantageous to the customer, the burden of showing the acceptable circumstances for doing so is on the retail firm. Examples of acceptable circumstances are where a customer’s order is “crossed” with another retail firm which has a corresponding order on the other side, or where the identity of the retail firm, if known, would likely cause undue price movements adversely affecting the cost or proceeds to the customer.

Failure to maintain or adequately staff an over-the-counter order room or other department assigned to execute customers’ orders cannot be considered justification for executing away from the best available market; nor can channeling orders through a third party as described above as reciprocation for service or business operate to relieve a member of his obligations. However, the channeling of customers’ orders through a broker’s broker or third party pursuant to established correspondent relationships under which executions are confirmed directly to the Firm acting as agent for the customer, such as where the third party gives up the name of the retail firm, are not prohibited if the cost of such service is *not* borne by the customer.

The obligations exist not only where the Firm acts as agent for the account of its customer but also where retail transactions are executed as principal and contemporaneously offset.

As noted above, the Supplementary Material to Rule 5310 includes the following new provisions:

Supplementary Material .06: Securities with Limited Quotation or Pricing Information

NASD Rule 2320(f), which was commonly referred to as the "Three Quote Rule," has been replaced with Supplementary Material .06. The new Supplementary Material emphasizes a firm's best execution obligations when handling an order involving any security, equity or debt, for which there is limited quotations or pricing information available. It stresses that a firm must be especially diligent with respect to best execution obligations when there is limited quotation or other pricing information available regarding the security that is the subject of the order and requires the firm to have written policies and procedures in place to address the steps the firm will take to determine the best market for such a security in the absence of multiple quotations or pricing information and to document how the firm has complied with those policies and procedures. The Supplementary Material specifically notes that, when handling orders for such securities, a firm should generally seek out other sources of pricing information or potential liquidity, which may include obtaining quotations from other sources (*e.g.*, other firms that the member firm previously has traded within the security). For example, in many instances, particularly in the context of equity securities with limited quotation information available, contacting other broker-dealers may be necessary to comply with a firm's best execution obligations. The Supplementary Material recognizes that contacting other broker-dealers can often be necessary for a firm to meet its best execution obligations.

Supplementary Material .07: Orders for Foreign Securities with No U.S. Market

Markets in foreign jurisdictions often do not have identical best execution requirements as those in the United States and, in many cases, may not have comparable pre-trade or post-trade transparency standards. Consequently, the handling of orders for foreign securities with no U.S. market can differ substantially from the handling of orders in securities that trade in the United States. Supplementary Material .07 to Rule 5310 addresses firms' best execution obligations when handling orders for foreign securities, and in particular foreign securities with no U.S. market.

Supplementary Material .07 recognizes that markets for different securities can vary dramatically and that the standard of "reasonable diligence" required by FINRA Rule 5310(a) must be assessed by examining specific factors, including "the character of the market for the security" and the "accessibility of the quotation." Accordingly, the determination as to whether a firm has satisfied its best execution obligations necessarily involves a "facts and circumstances" analysis. Supplementary Material .07 notes that even though a foreign security may not trade in the United States, firms still have an obligation to seek best execution for customer orders involving the security. Consequently, a firm that handles customer orders for foreign securities that do not trade in the United States must have specific written policies and procedures in place regarding its handling of customer orders for these securities that are reasonably designed to obtain the most favorable terms available for the customer, taking into account differences that may exist between U.S. markets and foreign markets. The Supplementary Material further notes that a firm's best execution obligations will evolve as changes occur in the market that may give rise to improved executions, including opportunities to trade at more advantageous prices. Firms must, therefore, regularly review their policies and procedures to assess the quality of executions received and update or revise the policies and procedures as necessary.

Supplementary Material .08: Customer Instructions Regarding the Routing of Orders

Supplementary Material .08 addresses situations where the customer has, on an unsolicited basis, specifically instructed the firm to route its order to a particular market. Under those circumstances, the firm is not required to make a best execution determination beyond that specific customer

instruction; however, the firm must process the customer's order promptly and in accordance with the terms of the order. Supplementary Material .08 also makes clear that, where a customer has directed the firm to route an order to another broker-dealer that is also a FINRA member firm, the exception would not apply to the receiving broker-dealer to which the order was directed.

Supplementary Material .09: Regular and Rigorous Review of Execution Quality

Supplementary Material .09 codifies a firm's obligations when it undertakes a regular and rigorous review of execution quality likely to be obtained from different market centers. These longstanding obligations are set forth and explained in various SEC releases and *Notices to Members*. Supplementary Material .09 codifies this guidance and does not alter existing requirements regarding regular and rigorous review. ►►

> **Implementation Strategy**
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> On a monthly basis, the designated principal shall monitor and review all *Execution Quality Analysis Reports* received from the clearing firm to determine if customers are receiving best execution.

14.10 Stock Volatility and Extreme Market Conditions

In accordance with *NTM 99-11*, broker/dealers are required to have adequate systems in place to properly handle high volume or high volatility trading days. As a result, all broker/dealer firms have a legal obligation to handling orders in a fair manner in addition to providing adequate and clear disclosures to customers about the risks arising out of evolving volatility and volume concerns and any related constraints on a firm's ability to process orders in a timely and orderly manner.

Therefore, all broker/dealer firms, both order entry firms (*i.e.*, firms with a retail business that route orders to other firms for execution) and integrated firms (*i.e.*, firms with a large retail business that also engage in market making and other activities), whether they offer on-line trading services or not are encouraged to consider making the following types of disclosures to educate retail customers about their procedures for handling the execution of a securities transaction, particularly during volatile market conditions, along with any additional disclosures they deem appropriate.

Delays

Firms should consider disclosing that high volumes of trading at the market opening or intra-day may cause delays in execution and executions at prices significantly away from the market price quoted or displayed at the time the order was entered. Firms should consider explaining to customers how order executions are handled by Market Makers, and explain that Market Makers may execute orders manually or reduce their size guarantees during periods of volatility, resulting in possible delays in order execution and losses.

Types of Orders

Firms should consider explaining in detail the difference between market and limit orders and the benefits and risks of each. In particular, firms should consider disclosing that they are required to execute a market order fully and promptly without regard to price and that, while a customer may receive a prompt execution of a market order, the execution may be at a price significantly different from the current quoted price of that security. Firms should tell customers that limit orders will be executed only at a specified price or better and that, while the customer receives price protection, there is the possibility that the order will not be executed.

As a related matter, firms should consider additional disclosure for customers who place market orders for initial public offering (IPO) securities trading in the secondary market, particularly those that trade at a much higher price than their offering price, or in “hot stocks” (those that have recently traded for a period of time under what is known as “fast market conditions,” in which the price of the security changes so quickly that quotes for a stock do not keep pace with the trading price of the stock). Firms may disclose that in such cases customers’ risk of receiving an execution substantially away from the market price at the time they place the order may be significantly reduced if they also include a cap (or floor) with the order above (or below) which the order is not to be executed, by placing a limit order.

Access

Firms should consider alerting customers that they may suffer market losses during periods of volatility in the price and volume of a particular stock when systems problems result in inability to place buy or sell orders. Customers trading on-line may have difficulty accessing their accounts due to high Internet traffic or because of systems capacity limitations. Customers trading through brokers at full-service or discount brokerage firms or through representatives of on-line firms when on-line trading has been disabled or is not available because of systems limitations may have difficulty reaching account representatives on the telephone during periods of high volume. Firms should explain their procedures for responding to these access problems.

Communication with the Public

Firms may use advertisements or sales literature to make claims about the speed and reliability of their trading services. These communications with the public must not exaggerate the members’ capabilities or omit material information about the risks of trading and the possibilities of delayed executions. Moreover, members should have the systems capacity to support any claims they make about their trading services.

Alternative Solutions for Handling Stock Volatility

Although some of the information above may be appropriate responses to trading in securities experiencing extraordinary volatility, they may not be sufficient or appropriate responses in all circumstances. Each action provides protection to the firm and obviously also impacts a firm’s customers wishing to trade those securities. Therefore, the following information provides additional alternatives for handling extreme stock volatility:

Hot IPOs and Hot Stocks

Under extreme stock volatility, a firm may also decide to halt on-line trading of hot IPOs and stocks, requiring customers to purchase these securities through a registered representative, either in person or via the telephone. When contacted, representatives can explain, for example, the difference between market and limit orders and the benefits and risks of each, and encourage customers whose primary goal is to achieve a target price and protect against sudden price moves, and who understand that there is a possibility that the order will not be executed, to enter limit orders. When used, this halt has been implemented only for a short period of time, typically one day.

Other firms may choose to not accept market orders for hot IPOs, requiring customers who wish to buy these stocks to enter a limit order specifying the highest price they would pay for these issues. Still other firms do not accept any orders for certain IPOs that are forecast to be hot until the IPO begins trading in the secondary market.

Margin

Some firms may raise margin requirements for volatile stocks. Some firms that permit on-line trading have raised the amount of equity that must be maintained in margin accounts (maintenance margin) for long positions in certain volatile stocks to between 40 percent and 100 percent. Increasing maintenance margin requirements protects both the firm and customers by ensuring that investors have more equity in their margin accounts as protection in case of a large change in the value of a stock, which reduces the likelihood that the firm will have to liquidate assets in the customer's account to meet a margin call.

Some on-line firms also have responded to recent volatility by prohibiting the use of margin to purchase certain securities. Some securities have been designated as "not marginable," requiring customers to purchase the securities with 100 percent initial margin, allowing payment to be made within three days of settlement. Firms also have designated certain securities as "cash on hand," requiring customers to have 100 percent of the purchase price of the security in the account before the transaction can be executed.

Investor Education

Many firms provide some kind of investor education on issues related to market volatility on their Web sites. This education may be found in a part of the Web site devoted generally to investor education and in firm newsletters. Many firms also have customer help desks and support agents, both of which provide answers to customer questions.

Pop-up or Splash Screens

Some firms may add a "pop-up" page that a customer must view when entering the customer account pages of their Web sites indicating, for example, that maintenance margin has been raised for certain listed securities; trade reports may be delayed; only limit orders will be accepted for certain securities; and the latest "real-time" quotes viewed on the site may not be reflective of the current trading price of a stock.

Operation of Automated Order Execution Systems during Turbulent Market Conditions

In accordance with *NTM 99-12*, broker/dealer firms should consider the following guidelines when evaluating whether their order execution algorithms or procedures are appropriate during turbulent market conditions.

- The treatment of customer orders under any order execution algorithm or procedure must remain fair, consistent, and reasonable;
- To the extent that a firm's order execution algorithm or procedures are different during turbulent market conditions, the firm should disclose to its order entry firms (and customers if applicable) the differences in the procedures from normal market conditions and the circumstances in which the firm may generally activate these procedures;
- Modifications to order execution algorithms or procedures designed to respond to turbulent market conditions may be implemented only when warranted by market conditions. Accordingly, firms should document the basis for activation of their modified procedures;
- Frequent activation of modified order execution algorithms or procedures because a firm has failed to maintain adequate system capacity to handle exceptional loads may raise best execution concerns;
- Failure to maintain or adequately staff an over-the-counter order room or other department assigned to execute customers' orders cannot be considered justification for executing away from the best available market. ►►

Implementation Strategy

The designated principal will ensure that the Firm's designated clearing firm (NFS), and its use of order entry and execution systems are capable of handling the Firm's order flow. On a periodic basis, designated supervisor will review the clearing firm's procedures to ensure that the clearing firm is providing sufficient order execution.

14.11 Margin Requirements during Extreme Market Volatility

During periods of extreme market volatility, the firm may incur additional risks from clients who effect transactions on a margin basis. General Market volatility or volatility in certain stocks can dramatically increase the firm's and the client's risk of losses or forced liquidations due to maintenance calls. As a result, the firm will reevaluate its margin requirements during periods of market volatility.

Pursuant to Rule 4210 (formally NASD Rule 2520), the designated principal will be responsible to ensure that the firm has adequate procedures to:

- Review margin limits and the various types of credit extended to clients;
- Compute its own (house) margin requirements above those required by *SEC Regulation T*; and
- Evaluate the necessity for implementing higher margin requirements.

When considering higher margin requirements the designated principal shall examine general market volatility, market capitalization, and fluctuations in particular stocks. The designated principal shall also create and maintain a list of "Non-Marginable" securities and ensure that the list is distributed to each registered person at the beginning of each day.

Note: Please see the Customer Accounts Section for further information.

14.12 Margin requirements for Exchange-Traded Notes (ETNs)

Pursuant to FINRA Rule 4210(f)(8)(A), FINRA is establishing higher strategy-based margin requirements for exchange-traded notes (ETNs) and options on ETNs in light of the complex nature of these products.

Increase in Strategy-Based Margin

The maintenance margin requirements on all "margin securities," which include debt securities, are generally set by FINRA Rule 4210(c). The rule requires strategy-based accounts to maintain equity equal to 25% of the current market value of all margin securities long in the account, and the greater of 5% of the principal amount or 30% of the current market value of debt securities short in the account.

As an exception to this general rule, reduced margin requirements for investment grade debt securities, listed non-equity securities and "other margin eligible non-equity securities" are set out in Rule 4210(e)(2)(C). Although ETNs may technically qualify for these reduced margin requirements (because they are listed on national securities exchanges and their issuers are generally rated investment-grade), they have materially different risk profiles than typical debt securities. Typical debt securities expose investors to issuer credit risk and a greater or lesser degree of interest rate risk, while ETN investors are exposed to issuer credit risk and also the risk of the reference index or benchmark. Because of the significance of the reference index or benchmark risk to an ETN position, FINRA believes that the exceptions provided by Rule 4210(e)(2)(C) should not apply to ETN positions in strategy-based accounts.

Pursuant to FINRA Rule 4210(f)(8)(A), FINRA is excluding ETNs from the exceptions available for positions in ordinary investment grade debt securities, listed non-equity securities and "other margin eligible non-equity securities," and establishing for them:

- an initial and maintenance margin requirement of 25% of the current market value for ETNs held long in an account, and 30% of the current market value for ETNs held short; and
- an initial and maintenance margin requirement on listed options on ETNs of 20% of the underlying current market value of the ETN, and a minimum margin requirement of 10% of the underlying current market value of the ETN, in each case for purposes of the listed options and warrants requirements chart in Rule 4210(f)(2)(E)(i).

Further, similar to the approach taken in Regulatory Notice 09-53 with respect to leveraged ETFs, FINRA is increasing the margin requirements (including day trading requirements) for leveraged ETNs and their associated uncovered options by a factor commensurate with their leverage. The margin requirement on a leveraged ETN held long in an account is capped at 100% of its value; however, no such cap applies for a leveraged ETN held short.

Portfolio Margin Treatment

As an alternative to the strategy-based margin requirements specified in FINRA Rule 4210(c)-(f), FINRA Rule 4210(g) permits members to margin certain products according to a prescribed portfolio margin methodology that is based on the Options Clearing Corporation's (OCC) Theoretical Intermarket Margining System (TIMS) model.

14.13 Disclosure of Order Routing Practices (SEC Rule 606; Formally Rule 11Ac1-6)

Under *SEC Rule 606* as adopted, a broker-dealer that routes orders on behalf of customers will be required to prepare quarterly reports that disclose the identity of the venues to which it routed orders for execution. The reports also will disclose the nature of the broker-dealer's relationship with those venues, including the existence of any internalization or payment for order flow arrangements. Additionally, broker-dealers will be required to disclose, upon request, where they routed a customer's individual orders for execution.

In a significant change from the rule as proposed, the Firm will not be required to prepare a narrative section for the reports that discusses and analyzes its order routing practices. In addition, the Firm will not be required to identify every venue to which it routed any orders. Instead, only the most significant venues - the top ten (10) and any others that received 5% or more of the broker-dealer's orders - must be disclosed.

Key Definitions

Covered Security. The definition of "covered security" includes not only national market system securities (i.e., exchange-listed equities and Nasdaq National Market equities), but also Nasdaq SmallCap equities and listed options. The Rule also applies to all broker/dealers that route orders on behalf of their customers.

Customer Order. The term "customer order" is defined as any order to buy or sell a covered security that is not for the account of a broker-dealer. It excludes, however, any order for a quantity of a security having a market value of at least $50,000 for a covered security that is an option contract and a market value of at least $200,000 for any other covered security.

Non-Directed Orders. Although *SEC Rule 606* applies to all types of orders, broker-dealers must give an overview of their routing practices only with respect to "non-directed orders." A non-directed order is any customer order other than a directed order. A directed order as a customer order that the customer specifically instructs the broker-dealer to route to a particular venue for execution. Consequently, all customer orders are non-directed orders in the absence of specific customer instructions on where they are to be routed.

Quarterly Reporting Requirements

SEC Rule 606 as adopted requires that a quarterly report be divided into four separate sections for four different types of covered securities: one for equity securities listed on the NYSE; one for equity securities qualified for inclusion in Nasdaq; one for equity securities listed on the Amex or any other national securities exchange; and one for options.

The Firm's quantitative description of order routing must include the percentage of total non-directed orders for the section routed to the venue, and the percentages of total non-directed market orders, non-directed limit orders, and non-directed other orders for the section that were routed to the venue. The quantitative description also will include the identity of the ten venues to which the largest number of non-directed orders for the section were routed for execution, as well as any venue to which five percent or more of non-directed orders were routed.

The Firm will be required to discuss the material aspects of its relationship with each venue identified in each section of the report, including a description of any payment for order flow arrangement or profit-sharing relationship as it relates to the type of securities for that section. However, broker/dealers are not required to provide a quantitative estimate of the aggregate dollar amount of payment for order flow received during a quarter from each order execution venue.

The Firm is only required to identify and prepare disclosures for their most significant execution venues. The SEC noted in the Adopting Release that, "the quarterly reports on order routing are intended to provide a general overview of a broker-dealer's practices that is accessible and useful to individual investors." To this end, the Rule requires broker-dealers to disclose only those execution venues to which they routed the most orders for a section of a report - the top ten and any others to which they routed five percent or more of orders.

Public Availability of Quarterly Reports

SEC Rule 606 requires broker-dealers to make publicly available for each calendar quarter a report on its routing of non-directed orders in covered securities. The term "make publicly available" requires the Firm to do three steps -- post on a free Internet web site, furnish a written copy on request, and notify customers at least annually that a written copy will be furnished on request. Each quarterly report shall be made publicly available within one month after the end of the quarter addressed in the report. ►►

> **Implementation Strategy**
>
> The Firm is exempt from *SEC Rule 606* pursuant to Division of Market Regulation, *Staff Legal Bulletin No. 13* and *Notice to Members 01-44*. Therefore, in accordance with SEC Staff Legal Bulletin No. 13, the Firm shall use a limited exemption from the Rule for broker-dealers that route a de minimus number of customer orders in covered securities for execution. Specifically, the SEC is exempting from the quarterly reporting requirement of *Rule 606* those firms that have routed, on average, 500 or fewer customer orders in covered securities per month during the preceding calendar quarter. Thus, for example, firms that routed fewer than 1500 customer orders during the second calendar quarter are exempted from the quarterly reporting requirement for the third quarter. The Commission emphasizes, however, that firms eligible for this limited exemption must still comply with *Rule 606,* which requires them to provide interested customers with routing information about specific orders and to notify customers annually that such information is available.
>
> The designated principal shall be responsible for monitoring trading activity in order to maintain the exemption from SEC Rule 606. In the event that the Firm no longer qualify for the exemption, the designated supervisor will be responsible for ensuring the Firm's compliance with such Rule.

14.14 Market Wide Trading Halts

In circumstances in which Nasdaq deems it necessary to protect investors and the public interest, Nasdaq may, in accordance with *Rule 4120* halt trading in the following areas:

- Halt trading in the over-the-counter market of a security listed on Nasdaq to permit the dissemination of material news; or
- Halt trading in the over-the-counter market of a security listed on a national securities exchange during a trading halt imposed by such exchange to permit the dissemination of material news; or
- Halt trading by CQS market makers in a CQS security when a national securities exchange imposes a trading halt in that CQS security because of an order imbalance or influx ("operational trading halt");
- Halt trading in an ADR or other security listed on Nasdaq, when the Nasdaq-listed security or the security underlying the ADR is listed on or registered with a national or foreign securities exchange or market for regulatory reasons;
- Halt trading in a security listed on Nasdaq when Nasdaq requests from the issuer information relating to material news,
- Halt trading in a security listed on Nasdaq when extraordinary market activity in the security is occurring.

Pursuant to Notice-to-Members 99-05, the firm will apply the following procedures during market wide trading halts due to extreme volatility or other technological circumstances.

- The Firm shall not effect any transaction or publish a quotation in any security as to which a trading halt is currently in effect;
- During market-wide trading halts of durations that will allow trading to resume on that same trading day, pending and new customer orders will be forwarded to the appropriate market for execution upon the resumption of trading. This should be done unless the member receives contrary instructions from the customer during the halt;
- During market-wide trading halts resulting from the triggering of circuit breakers, customer orders will be handled in the same manner as they would be handled during other regulatory trading halts concerning only individual stocks (see trading halts);
- During market-wide trading halts with durations that will close the market for the remainder of the trading day, pending and new customer orders should be treated as follows:
    - Unless otherwise instructed by the customer, orders that are pending at the time of the halt, and new orders received after the halt has commenced, will be treated as "*Good-Til-Cancelled*" orders and be held by the member for execution at the reopening of the next trading session.
    - "At-the-Close" orders (including "Market-at-Close" orders) pending at the time trading is halted will be treated as cancelled orders. Members should not accept, or forward to a market, any new orders related to closing prices received during a trading halt.

Prohibiting Trading Ahead of Customer Market Orders under Certain Circumstances

Rule 2111 prohibits a member that accepts and holds a customer market order from trading for its own account on the same side of the market as the customer market order at prices that would satisfy the customer's order, unless it immediately thereafter executes the customer market order up to the size and at the same price or better at which it traded for its own account. Similar to the application of the Manning Rule, customer market orders would include orders received from the member's own customers or customer orders received from another broker-dealer.

In addition, if a member is holding a customer market order that has not been immediately executed, Rule 2111 requires that the member make every effort to match the pending market order against any market orders, marketable limit orders or non-marketable limit orders priced better than the best bid or offer, received by the member on the other side of the market. Such orders must be executed at a price that is no less than the best bid, no greater than the best offer at the time the subsequent order is received by the member, and consistent with the terms of the pending market order.

In the event that a member is holding multiple orders on both sides of the market that have not been executed, the member must make every effort to cross or otherwise execute such orders in a manner that is reasonable and is consistent with the objectives of the rule and with the terms of the orders. Members must have a written methodology in place governing the execution priority of all such pending orders, whether the member is holding one order or multiple orders on both sides of the market, and must ensure that such methodology is consistently applied.

Rule 2111 also applies to limit orders that are marketable at the time they are received by the member or that become marketable at a later time. Once marketable, such limit orders are treated as market orders for purposes Rule 2111; however, these orders must continue to be executed at their limit price or better. If a customer limit order is not marketable when received, the limit order must be provided the full protections of the Manning Rule, as applicable. In addition, if the limit order was marketable when received and then becomes non-marketable, once the limit order becomes non-marketable, it must be provided the full protections of Manning Rule.

Rule 2111 applies to FINRA members irrespective of the market or market center upon which they trade. As such, if a member were to execute a proprietary trade on an exchange while holding a customer market order on the same side of the market, the member will be deemed to have violated Rule 2111 unless (1) the member immediately provides an execution to that market order at a price equal to or better than the proprietary trade; or (2) the member's proprietary trade was in accordance with a functional role, recognized within the rules of that exchange, of acting as a liquidity provider, such as acting in the role of a specialist or some other substantially similar capacity.

Rule 2111 also incorporates several of the same types of exclusions that apply to the Manning Rule.

- Rule 2111 permits members to negotiate specific terms and conditions applicable to the acceptance of a market order with respect to a market order for customer accounts that meet the definition of an "institutional account" as that term is defined in Rule 3110(c)(4) or a market order that is for 10,000 shares or more, unless such order is less than $100,000 in value.

- Rule 2111 provides an exception for member proprietary trades that are part of an execution, on a riskless principal basis, of another order from a customer (whether its own customer or the customer of another member) (the "facilitated order"). This exclusion applies only if the following requirements are met: (1) the handling and execution of the facilitated order must satisfy the definition of a "riskless" principal transaction, as that term is defined in FINRA rules; (2) the member must give the facilitated order the same per-share price at which the member accumulated or sold shares to satisfy the facilitated order, exclusive of any markup or markdown, commission equivalent or other fee; (3) a member must submit, contemporaneously with the execution of the facilitated order, a report as defined in FINRA

Rules 6380A (formally NASD Rule 4632(d)(3)(B)(ii)), FINRA Rule 6740 (formally NASD Rule 6420(d)(3)(B)(ii)) or FINRA Rules 6380A (formally NASD Rule 4632A(e)(1)(C)(ii, or a substantially similar report; and (4) members must have written policies and procedures to assure that riskless principal transactions relied upon for this exclusion comply with applicable FINRA rules. (NTM 05-69; Effective Jan. 9, 2006; Ref. NTM 06-03) ►►

Implementation Strategy

In the event that the Firm accepts and holds a customer market order (including orders received from the Firm's own customers or customer orders received from another broker/dealer) and trades such order for its own account on the same side of the market as the customer market order at prices that would satisfy the customer's order, the Firm must immediately thereafter execute the customer market order up to the size and at the same price or better at which it traded for its own account.

Additionally, if the Firm is holding a customer market order that has not been immediately executed, the Firm is required to make every effort to match the pending market order against any market orders, marketable limit orders or non-marketable limit orders priced better than the best bid or offer, received by the Firm on the other side of the market. Such orders must be executed at a price that is no less than the best bid, no greater than the best offer at the time the subsequent order is received by the Firm, and consistent with the terms of the pending market order.

In the event that the Firm is holding multiple orders on both sides of the market that have not been executed, the Firm must make every effort to cross or otherwise execute such orders in a manner that is reasonable and is consistent with the objectives of the rule and with the terms of the orders.

Note: The Firm does not currently trade equities in its own account.

13.15 Market Order Protection

Prohibiting Trading Ahead of Customer Market Orders under Certain Circumstances

Rule 2111 prohibits a member that accepts and holds a customer market order from trading for its own account on the same side of the market as the customer market order at prices that would satisfy the customer's order, unless it immediately thereafter executes the customer market order up to the size and at the same price or better at which it traded for its own account. Similar to the application of the Manning Rule, customer market orders would include orders received from the member's own customers or customer orders received from another broker-dealer.

In addition, if a member is holding a customer market order that has not been immediately executed, Rule 2111 requires that the member make every effort to match the pending market order against any market orders, marketable limit orders or non-marketable limit orders priced better than the best bid or offer, received by the member on the other side of the market. Such orders must be executed at a price that is no less than the best bid, no greater than the best offer at the time the subsequent order is received by the member, and consistent with the terms of the pending market order.

In the event that a member is holding multiple orders on both sides of the market that have not been executed, the member must make every effort to cross or otherwise execute such orders in a manner that is reasonable and is consistent with the objectives of the rule and with the terms of the orders. Members must have a written methodology in place governing the execution priority of all such pending orders, whether the member is holding one order or multiple orders on both sides of the market, and must ensure that such methodology is consistently applied.

Rule 2111 also applies to limit orders that are marketable at the time they are received by the member or that become marketable at a later time. Once marketable, such limit orders are treated as market orders for purposes Rule 2111; however, these orders must continue to be executed at their limit price or better. If a customer limit order is not marketable when received, the limit order must be provided the full protections of the Manning Rule, as applicable. In addition, if the limit order was marketable when received and then becomes non-marketable, once the limit order becomes non-marketable, it must be provided the full protections of Manning Rule.

Rule 2111 applies to FINRA members irrespective of the market or market center upon which they trade. As such, if a member were to execute a proprietary trade on an exchange while holding a customer market order on the same side of the market, the member will be deemed to have violated Rule 2111 unless (1) the member immediately provides an execution to that market order at a price equal to or better than the proprietary trade; or (2) the member's proprietary trade was in accordance with a functional role, recognized within the rules of that exchange, of acting as a liquidity provider, such as acting in the role of a specialist or some other substantially similar capacity.

Rule 2111 also incorporates several of the same types of exclusions that apply to the Manning Rule.

- Rule 2111 permits members to negotiate specific terms and conditions applicable to the acceptance of a market order with respect to a market order for customer accounts that meet the definition of an "institutional account" as that term is defined in Rule 3110(c)(4) or a market order that is for 10,000 shares or more, unless such order is less than $100,000 in value.

- Rule 2111 provides an exception for member proprietary trades that are part of an execution, on a riskless principal basis, of another order from a customer (whether its own customer or the customer of another member) (the "facilitated order"). This exclusion applies only if the following requirements are met: (1) the handling and execution of the facilitated order must satisfy the definition of a "riskless" principal transaction, as that term is defined in FINRA rules; (2) the member must give the facilitated order the same per-share price at which the member accumulated or sold shares to satisfy the facilitated order, exclusive of any markup or markdown, commission equivalent or other fee; (3) a member must submit, contemporaneously with the execution of the facilitated order, a report as defined in FINRA Rules 6380A (formally NASD Rule 4632(d)(3)(B)(ii)), FINRA Rule 6740 (formally NASD Rule 6420(d)(3)(B)(ii)) or FINRA Rules 6380A (formally NASD Rule 4632A(e)(1)(C)(ii, or a substantially similar report; and (4) members must have written policies and procedures to assure that riskless principal transactions relied upon for this exclusion comply with applicable FINRA rules. (NTM 05-69; Effective Jan. 9, 2006; Ref. NTM 06-03) ►►

Implementation Strategy

In the event that the Firm accepts and holds a customer market order (including orders received from the Firm's own customers or customer orders received from another broker/dealer) and trades such order for its own account on the same side of the market as the customer market order at prices that would satisfy the customer's order, the Firm must immediately thereafter execute the customer market order up to the size and at the same price or better at which it traded for its own account.

Additionally, if the Firm is holding a customer market order that has not been immediately executed, the Firm is required to make every effort to match the pending market order against any market orders, marketable limit orders or non-marketable limit orders priced better than the best bid or offer, received by the Firm on the other side of the market. Such orders must be executed at a price that is no less than the best bid, no greater than the best offer at the time the subsequent order is received by the Firm, and consistent with the terms of the pending market order.

In the event that the Firm is holding multiple orders on both sides of the market that

have not been executed, the Firm must make every effort to cross or otherwise execute such orders in a manner that is reasonable and is consistent with the objectives of the rule and with the terms of the orders.

Note: The Firm does not currently trade equities in its own account.

14.16 Trading Ahead of Customer Limit Order

On February 26, 2007, the Securities and Exchange Commission (SEC) approved amendments to Interpretive Material (IM) 2110-2, Trading Ahead of Customer Limit Order, to apply to over-the-counter (OTC) equity securities. The amendments also modify the minimum price improvement standards set forth in IM-2110-2 with respect to both NMS stocks and OTC equity securities. IM-2110-2, The amendments become effective on July 26, 2007.

IM-2110-2 generally prohibits a member from trading for its own account in an NMS stock at a price that is equal to or better than an unexecuted customer limit order in that security, unless the member immediately thereafter executes the customer limit order at the price at which it traded for its own account or a better price.

Rule 6541 (Limit Order Protection), which is similar but not identical to IM-2110-2, applies the general principles of IM-2110-2 to a subset of OTC equity securities—those that are quoted on the OTC Bulletin Board (OTCBB). On February 26, 2007, the SEC approved amendments that expand the scope of IM-2110-2 to apply to all OTC equity securities and delete Rule 6541, as those requirements are now subsumed in IM-2110-2.

Effective July 26, 2007, members must comply with the requirements of IM-2110-2 for those limit orders previously covered by FINRA Rule 6560 (formally NASD Rule 6541).

- First, both IM-2110-2 and Rule 6541 provide that a member is not deemed to have traded ahead of a customer limit order if the member provides a contemporaneous execution of the customer's order FINRA Rule 6560 (formally NASD Rule 6541) currently provides a maximum time limit of five minutes, within which an execution of a customer order will be deemed contemporaneous with an execution for a member firm's account. IM-2110-2 prescribes a shorter maximum time limit (as soon as possible, but absent reasonable and documented justification, within one minute) within which an execution of a customer order will be deemed contemporaneous with an execution for the firm's account. In addition, FINRA Rule 6560 (formally NASD Rule 6541)requires that the customer limit order be executed at the limit price, while IM-2110-2 requires that the customer limit order be executed at the price of the firm's execution if better than the limit price. Accordingly, upon implementation of the amendments, members must comply with the IM-2110-2 standard for all securities.

- Second, IM-2110-2 contains a higher dollar value threshold for the order size at which firms may negotiate terms and conditions to permit them to continue to trade along side of, or ahead of, the limit order, if the customer agrees. FINRA Rule 6560 (formally NASD Rule 6541) requires that an order be 10,000 shares or more and greater than $20,000 in value, while IM-2110-2 requires that an order be 10,000 shares or more and greater than $100,000 in value. Upon implementation of the amendments, members must comply with the higher dollar value threshold for all securities.

- Third, IM-2110-2 applies from 9:30 a.m. to 6:30 p.m. Eastern Time (ET), whereas Rule 6541 currently applies only during the normal market hours of 9:30 a.m. to 4:00 p.m. ET

- Finally, IM-2110-2 and FINRA Rule 6560 (formally NASD Rule 6541) contain different standards relating to the minimum level of price improvement that a member must provide to trade ahead of an unexecuted customer limit order FINRA Rule 6560 (formally NASD Rule 6541) requires that for customer limit orders priced at or inside the current inside spread, the minimum price

improvement must be a minimum of the lesser of $.01 or one-half (1/2) of the current inside spread. IM-2110-2 currently requires a minimum price improvement of a $.01 for limit orders priced at or inside the best inside market. For customer limit orders priced outside the best inside market, IM-2110-2 currently requires minimum price improvement at a price at least equal to the next superior minimum quotation increment, while Rule 6541 does not set a minimum price level (although it does require price improvement in such circumstances)

The amendments revise the price-improvement standards for both NMS stocks and OTC equity securities, making them uniform depending on the price of the customer limit order and whether it is priced inside or outside the best inside market. Specifically, for customer limit orders priced greater than or equal to $1.00 that are at or inside the best inside market, the minimum amount of price improvement required is $0.01. For customer limit orders priced less than $1.00 that are at or inside the best inside market, the minimum amount of price improvement required is the lesser of $0.01 or one-half (1/2) of the current inside spread. For customer limit orders priced outside the best inside market, the member is required to execute the incoming order at a price at or inside the best inside market for the security. Lastly, for customer limit orders in securities for which there is no published inside market, the minimum amount of price improvement required is $0.01 (NTM 07-19; Effective July 26, 2007)

Note: The Firm does not currently trade equities in its own account