

Options Account Approval, Supervision and Margin

FINRA Reminds Members About Options Account Approval, Supervision and Margin Requirements

Summary

With the recent increase in the number of customers seeking to open brokerage accounts and trade options, FINRA reminds members of the requirements for determining whether to approve a customer to trade options. Regardless of whether the account is self-directed or options are being recommended, members must perform due diligence on the customer and collect information about the customer to support a determination that options trading is appropriate for the customer. In addition, FINRA reminds members that options accounts are subject to specific supervisory reviews, including, among others, reviewing the compatibility of options transactions with investment objectives and with the types of transactions for which the account was approved, and are subject to other FINRA rules that apply when opening customer accounts, including among others, customer identification requirements under anti-money laundering rules. FINRA also reminds members of the margin requirements for options transactions.

Questions concerning this *Notice* should be directed to:

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Background & Discussion

With the recent increase in the number of customers seeking to open self-directed brokerage accounts, FINRA reminds members of the requirements when a customer is seeking to trade options in his or her account. FINRA Rule 2360 sets forth the approval process with which members must comply when opening a customer's brokerage account for options as well as the requirement of ongoing specific supervisory reviews for options accounts.¹ These requirements are outlined in FINRA Rule 2360(b)(16) and FINRA Rule 2360(b)(20), respectively, which are consistent with the rules of the options exchanges.² While these provisions are long-standing, it is

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Notice Type

- ▶ Guidance

Suggested Routing

- ▶ Compliance
- ▶ Institutional
- ▶ Internal Audit
- ▶ Legal
- ▶ Margin
- ▶ Operations
- ▶ Options
- ▶ Registered Representatives
- ▶ Senior Management
- ▶ Trading

Key Topics

- ▶ Margin
- ▶ Options Account Opening
- ▶ Options Disclosure Document
- ▶ Supervision
- ▶ Uncovered Short Option Contracts
- ▶ Verification of Customer Background and Financial Information

Referenced Rules & Notices

- ▶ Exchange Act Rule 15l-1
- ▶ FINRA Rule 2111
- ▶ FINRA Rule 2210
- ▶ FINRA Rule 2220
- ▶ FINRA Rule 2264
- ▶ FINRA Rule 2360
- ▶ FINRA Rule 4210
- ▶ Notice to Members 80-23
- ▶ SEA Rule 17a-3

important that members review their policies and procedures on these topics to ensure they are fully complying with the requirements.³ In addition, FINRA reminds members that other rules apply when opening customer accounts, including FINRA Rule 4512 specifying the information that a member shall maintain regarding a customer; FINRA Rule 2090 requiring that a member use “reasonable diligence” in regard to the opening and maintenance of each account to know the “essential facts” concerning each customer; and FINRA Rule 3310(b) and related anti-money laundering requirements, under which broker-dealers are required to establish and maintain a written Customer Identification Program to verify the identity of a customer who seeks to open a brokerage account.⁴

FINRA rules require that each customer must be specifically approved (or disapproved) for options trading prior to the time the member accepts an options order from the customer, regardless of whether the brokerage account is self-directed or options are being recommended.⁵ The rule sets forth the steps that must be taken as part of that approval. FINRA Rule 2360(b)(16) requires a member to exercise due diligence to ascertain the essential facts relative to the customer. Specifically, the member must seek to obtain and consider detailed customer information, including, among others, the customer’s knowledge, investment experience, age, financial situation and investment objectives.⁶

Based upon this information the member must determine whether it is appropriate to approve the customer to trade options.⁷ This approval process must consider the appropriateness of the full range of options trading being approved for the customer. As part of this approval process, members also should consider whether to approve a customer only for certain types of options transactions and not for others.⁸ A customer may, for example, be approved for one or more of the following types of options transactions: (1) purchases of puts and calls only; (2) covered call writing; (3) uncovered put and call writing; and (4) options spread transactions. In certain cases, members may require minimum dollar amounts in accounts for particular types of options transactions or may find it useful to place dollar limitations on options transactions of various types. As discussed below, members should also carefully consider the amount of credit extended to a customer for options transactions.

Members are responsible for establishing policies and procedures for options account approval, based on the information provided by the customer and consistent with the firm’s supervisory framework. Furthermore, if a customer seeks to write uncovered short option contracts, members must use specific criteria and standards in evaluating the suitability of the customer for writing these transactions and must deliver the special written statement.⁹

It is important for members to have accurate and complete data about a customer’s financial situation and objectives, along with the other required information, to enable the member to fully review the account to determine whether to approve (or disapprove)

the account for options trading. While not every customer may give all the information requested, members must note this refusal to provide information in customers' records and consider it together with other information available as part of reviewing whether and to what extent to approve the account for options trading.¹⁰ The approval must be performed by a branch office manager, Registered Options Principal or a Limited Principal—General Securities Sales Supervisor.¹¹

Members must also verify the background and financial information by giving the customer the opportunity to correct any information. Unless the information is included in the customer's account agreement, the customer's background and financial information must be sent to the customer for verification within 15 days after the customer's account has been approved for options trading.¹² If a member becomes aware of any material change in the customer's financial situation, the current background and financial information must be sent to the customer for verification within 15 days. While the rule provides that the information is deemed verified if the customer doesn't respond to the contrary, members should encourage customers to review the information provided and determine whether any updates or additions are necessary.

In addition to the requirement in FINRA Rule 2360(b)(16) to specifically approve (or disapprove) a customer's account to trade options, the rule requires that members must furnish the customer with the document entitled [Characteristics and Risks of Standardized Options](#), also known as the options disclosure document available on the Options Clearing Corporation's website. The options disclosure document contains the basic information about options, including defined terms and exercise procedures, principal risks of options positions and examples of different types of options. Members should encourage customers to read this information as well as other educational material to ensure customers understand the risks of trading options.¹³

FINRA also reminds members of their obligations under Regulation BI when they make recommendations of options transactions or investment strategies involving options (including account recommendations) to retail customers.¹⁴ Further, any options communications must be in conformance with the communications rules.¹⁵ In addition, members must retain options accounts records to permit timely and periodic supervisory reviews, including, among others, reviewing the compatibility of options transactions with investment objectives and with the types of transactions for which the account was approved.¹⁶ Members also must retain records to permit the review of the size and frequency of options transactions, profit or loss in the account and any undue concentration in the account.¹⁷ Members are expected to review accounts for these areas of concern as well as ensuring their written supervisory systems policies and procedures adequately address the members' options business. Members also must retain records of the customer information, approval decisions and supervisory review materials.¹⁸

Option transactions are often required to be effected in a margin account, including transactions when an option is not paid for in full or there is a short sale of an option that is not covered by the customer. Almost all option spread transactions are required to be in a margin account. Accordingly, members are reminded that FINRA Rule 4210 sets forth the maintenance margin requirements for options transactions.¹⁹ In addition, the rule requires firms to have procedures to review the limits and types of credit extended to all customers, to review the need for higher margin requirements for individual securities and customers, and to formulate their own margin requirements.²⁰ Further, members are reminded that FINRA Rule 2264 requires that members furnish non-institutional customers a margin disclosure statement prior to opening a margin account that explains the risks of trading on margin.²¹

Endnotes

1. In addition to the requirements specific to options set forth in FINRA Rule 2360(b), FINRA Rule 2090 (Know Your Customer) generally requires every member to use reasonable diligence, in regard to the opening and maintenance of every account, to know and retain the essential facts concerning every customer and concerning the authority of each person acting on behalf of such customer. Moreover, FINRA reminds members that, if a member or its associated person makes a recommendation to a retail customer to open an options account or makes a recommendation of an option or investment strategy involving options, then Regulation Best Interest also would apply. *See* Regulation Best Interest, Exchange Act Rule 15c-1.

See also the SEC’s Division of Examinations 2021 Examination Priorities. The priorities include examination of broker-dealers to assess whether they are meeting their legal and compliance obligations when providing retail customers access to complex strategies, such as options trading, and complex products.

 The former Chairman of the SEC, Jay Clayton; Dalia Blass, former Director, Division of Investment Management; William Hinman, former Director, Division of Corporation Finance; Brett Redfearn, former Director, Division of Trading and Markets issued a joint statement stating they will review the effectiveness of the existing regulatory requirements in protecting investors—particularly those with self-directed accounts—who invest in complex products. The statement provided that the SEC staff would welcome the views of all market participants and the public and encouraged comments through the following address: complexproductsreview@sec.gov. *See* Joint Statement Regarding Complex Financial Products and Retail Investors, dated October 28, 2020.
2. *See, e.g.*, Cboe Rule 9.1 (Opening of Accounts) and 9.2(j) (Supervision of Accounts).
3. The options sales practice requirements were harmonized across the industry after the advent of listed option trading. *See* Report of the Special Study of the Options Markets to the Securities and Exchange Commission (the “Special Study”) (December 22, 1978) and SEC Plan for Implementing of Recommendations of the Special Study (February 22, 1979). The Special Study called for close cooperation among the SROs and the SEC, and it recommended several specific actions designed to correct the deficiencies found by the SEC in surveillance and sales practices, including a recommendation that SROs amend their options account opening requirements to ensure that broker-dealers obtain and record sufficient data to support a suitability determination and require verification of such suitability information as well as supervisory review of a customer’s options account.
4. *See* 31 CFR 1023.220; FINRA Rule 3310(b). For further information on Anti-Money Laundering requirements, please visit the [FINRA Anti-Money Laundering \(AML\) page](#). FINRA also reminds members of the recordkeeping requirements of SEA Rule 17a-3 with respect to accounts.
5. *See* FINRA Rule 2360(b)(16).
6. The rule lists the minimum information that members should gather from customers who are natural persons. *See* FINRA Rule 2360(b)(16)(B)(i). The rule also lists specified information that members must be retain in a customer’s account records, including sources of background information and financial information concerning the customer. *See* FINRA Rule 2360(b)(16)(B)(ii). Information considered in approving an account for options must be reflected in the records of the

account. See FINRA Rule 2360(b)(16)(B)(v). FINRA encourages members to use a standard account agreement to facilitate obtaining all required information. FINRA also reminds members of the recordkeeping requirements of SEA Rule 17a-3.

7. See *Notice to Members 80-23* (June 1980) at 5 (“The requirement that all public customers must be specifically approved for options is intended to assure that the firm has exercised due diligence to determine that options transactions are appropriate for the customer in light of his investment objectives and financial situation, and that the customer has been made aware of the risks of options transactions. For these reasons, firms are required to seek to obtain specified minimum information concerning the customer’s financial background and investment experience, and to provide the customer with a current OCC prospectus.”) In this context of evaluating customer information for the purposes of approving a customer to trade options, FINRA views the options trading approval standard, which is expressed as appropriateness in *NASD Notice to Members 80-23*, as comparable to a suitability standard as used in Rule 2360(b)(19). FINRA further notes that The Special Study, which lay the foundation for updating the options rules adopted by FINRA and the options exchanges, was focused on ensuring that broker-dealers carefully approved customers to trade options based on adequate information. The Special Study referred to the account approval process as “determining the suitability of options trading for a customer.” See the Special Study at 49). See also SEC’s staff’s [“Investor Bulletin: Opening an Options Account”](#) (2015). (This bulletin explained that a broker will determine whether options trading is suitable for the prospective options customer.)
8. See FINRA Rule 2360(b)(16)(B)(ii)d. and FINRA Rule 2360(b)(20)(C). See also *Notice to Members 80-23* at 4.
9. See FINRA Rule 2360(b)(16)(E).
10. See FINRA Rules 2360(b)(16)(A) and 2360(b)(16)(B)(iv).
11. If the branch office manager is not a Registered Options Principal or a Limited Principal—General Securities Sales Supervisor, account approval or disapproval shall within ten business days be submitted to and approved or disapproved by a Registered Options Principal or a Limited Principal—General Securities Sales Supervisor. See FINRA Rule 2360(b)(16)(B).
12. See FINRA Rule 2360(b)(16)(C). The member must also obtain the customer’s written agreement to be bound by the FINRA rules applicable to the trading of option contracts and the OCC rules. See FINRA Rule 2360(b)(16)(D).
13. See e.g., FINRA’s website regarding [investor alerts](#) concerning options. Other resources for information regarding options include [SEC investor bulletins](#), the [Options Industry Council website](#) and the [OCC’s investor education resources](#).
14. See note 1 regarding Regulation Best Interest, FINRA Rules 2111 and 2360(b)(19).
15. See FINRA Rules 2210 and 2220.
16. See FINRA Rule 2360(b)(20)(C).
17. See FINRA Rule 2360(b)(20)(C).
18. See FINRA Rules 2360(b)(16)(B)(v) and 2360(b)(20)(C).

19. Members should ensure communications to customers about margin—whether the customer has a margin account or that a customer is using margin—are complete and accurate.
20. *See* FINRA Rule 4210(d).
21. *See* FINRA Rule 2264. Members must deliver to all non-institutional customers with margin accounts an annual margin disclosure statement that may be delivered within or as part of other account documentation. *See also* Exchange Act Rule 15c2-5 (Disclosure and Other Requirements When Extending or Arranging Credit in Certain Transactions) (requiring broker-dealers to deliver a written statement with specified information, including risks of the transaction) and Exchange Act Rule 10b-16 (Disclosure of Credit Terms in Margin Transactions) (requiring disclosure of credit terms).