optionsXpress Callable Securities Impartial Lottery System

FINRA Rule 4340, based in part on NYSE Rule 402.30 (Securities Callable in Part), requires a firm that has in its possession or control bonds or preferred stocks that are callable in part, whether specifically set aside or otherwise, to identify such securities and establish an impartial lottery system by which it will allocate among its customers the securities to be redeemed or selected as called in the event of a partial redemption or call. The rule applies to any security that by its terms may be called or redeemed prior to maturity.

If the quantity of called bonds or called preferred shares is less than the total units held by all accounts with a position in the called security, the automated allocation algorithm is used to identify the accounts to which an allocation is issued.

A random number is generated based on the NASDAQ Volume Index reported on Phase3's RPT347 on the call date. This constantly changing number is used to create an algorithm that randomly selects a starting point among the firm's accounts with positions in the callable security.

In the following example, there is a call on 5,400 units of XYZ. There are 11 accounts holding a total of 11,200 units, as illustrated by the table at the end of the example.

An interval of sequential numbers is given to all holders of the callable security, based on the number of units held by each account. For example, account 10000111, which is the lowest account number with a position in the callable security, has 500 units. Sequential numbers 1 through 500 are given to that account. The next highest account number, 10000222, is has 700 units. Numbering for that account starts at the next sequential number (501). The ending sequence number is obtained by adding the number of units in that account (700) to the previous ending number (500), which equals 1200. Thus, the sequential numbers for account 10000222 are 501 through 1200. This procedure continues for the other accounts.

The calculation uses the NASDAQ Volume Index, selecting the four digits in the hundreds, tens, ones, and tenths positions of the NASDAQ Volume Index figure. For example, if the NASDAQ Volume Index is 12,573.624, the four digits would be 573.6. We multiply that by ten and then take the inverse of that number to come up with our random allocation variable. In this case, it would be 6375. That number is divided by 10,000 and the result is added to 0.0001. This random number is then multiplied by the total number of units of the callable security held in accounts, i.e., (0.6375 + 0.0001) x 11,200 = 7141.12. Then, the figure is rounded up to the next integer (7142 in the example), which becomes the starting point.

Account number 40000222 has the sequential interval numbers 5301 to 7300 and will be allocated 159 units (the starting sequential number 7142 is assigned one unit, and the next number 7143 is assigned another unit, etc.). The accounts are then allocated on an ascending sequential number basis. After the highest sequential number has been allocated, the lowest number will follow until the allocated quantity has been satisfied.

Account	Callable Position	Sequential Interval	Assigned Allocation	Allocation Order	Remaining Position
10000111	500	1 – 500	500	5th	0
10000222	700	501 – 1200	700	6th	0
20000111	200	1201 – 1400	141	7th	59
20000222	1000	1401 – 2400	--	--	1000
30000111	1500	2401 – 3900	--	--	1500
30000222	800	3901 – 4700	--	--	800
40000111	600	4701 – 5300	--	--	600
40000222	2000	5301 – 7300	159	1st	1841
50000111	1200	7301 – 8500	1200	2nd	0
50000222	2500	8501 – 11000	2500	3rd	0
60000111	200	11001 – 11200	200	4th	0
	---		---		---
Total	**11200**		**5400**		**5800**

FINRA Rule 4340(b) and (c): Favorable and Unfavorable Redemptions prohibits member firms from allocating callable securities to any of its “associated persons” accounts in a redemption offered on terms favorable to a customer until all other customers’ positions have been satisfied. Exchange Act Section 3(a)(18) expressly excludes clerical and ministerial persons associated with the firm. Therefore the Firm will exclude all of the accounts of associated persons with the exception of the accounts of clerical or ministerial associated persons in the “favorable redemption” allocation pool. However, where the redemption of callable securities is offered on terms unfavorable to a customer, the Firm will include all accounts of associated persons including the accounts of clerical and ministerial associated persons.

optionsXpress, Inc. (Member SIPC) and Charles Schwab & Co., Inc. (Member SIPC) are separate but affiliated companies and subsidiaries of The Charles Schwab Corporation.

Copyright © 2015 optionsXpress, Inc. All rights reserved. Member SIPC