

Brant K. Brown
Associate General Counsel

Direct: (202) 728-6927
Fax: (202) 728-8264

December 1, 2011

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. SR-FINRA-2011-052 – Response to Comments

Dear Ms. Murphy:

This letter responds to the comment letter submitted to the Securities and Exchange Commission (“SEC”) regarding SR-FINRA-2011-052, a proposed rule change to adopt NASD Rule 2320 (Best Execution and Interpositioning) and IM-2320 (Interpretive Guidance with Respect to Best Execution Requirements) as FINRA Rule 5310 in the consolidated FINRA rulebook. The proposed rule change was published in the *Federal Register* on October 21, 2011, and comments were due by November 14, 2011.¹

The proposed rule change adopts new FINRA Rule 5310, which is based largely on NASD Rule 2320 and IM-2320 but includes several changes and additions. First, the proposed rule change replaces NASD Rule 2320(f) (also known as the Three Quote Rule) with Supplementary Material emphasizing a member’s best execution obligations when handling an order involving any security, equity or debt, for which there is limited pricing information available. Second, the proposed rule change includes new Supplementary Material codifying a member’s obligations when it undertakes a regular and rigorous review of execution quality likely to be obtained from different market centers. Third, the proposed rule change includes new Supplementary Material concerning members’ best execution obligations when handling orders for foreign securities, and in particular foreign securities with no U.S. trading activity. Finally, the proposed rule change includes Supplementary Material addressing situations where a customer has, on an unsolicited basis, specifically instructed a member to route its order to a particular market.

¹ Securities Exchange Act Release No. 65579 (Oct. 17, 2011), 76 FR 65549 (Oct. 21, 2011).

The Commission received one comment letter, from the Financial Services Institute (“FSI”), in response to the proposed rule change.² FSI’s letter addresses only the proposed Supplementary Material concerning best execution requirements for foreign securities, specifically, those with no U.S. market. FSI suggests that FINRA “amend the Supplementary Material to include the expectation that member firms draft and maintain written policies and procedures regarding these foreign securities that include the following elements:

1. Are reasonably designed to obtain favorable terms,
2. Provide reasonable notice to customers of the policies and procedures,
3. Require periodic review for compliance with policies, and
4. Require periodic review of the policies themselves to ensure that they meet the requirements of this rule.”

FSI states that it believes that the suggested provisions would help firms in developing clear standards and facilitate compliance with the rule.

For the reasons set forth below, FINRA does not believe that the Supplementary Material needs to be amended. FINRA believes that the first item FSI suggests adding, that the policies and procedures are reasonably designed to obtain favorable terms, is already addressed sufficiently in the Supplementary Material as proposed. Supplementary Material .07 to FINRA Rule 5310 states that “a member that handles customer orders involving foreign securities that do not trade in the U.S. 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.” FINRA believes this language, which uses the existing standard in the best execution rule, sufficiently addresses FSI’s first point.

The second item FSI suggests adding is a requirement that members provide reasonable notice to customers of the member’s policies and procedures regarding foreign securities with no U.S. market. FINRA does not believe it is appropriate to differentiate among a member’s best execution policies and procedures to specifically require notification in the context of foreign securities. Further, many customers, particularly retail customers, may not trade in foreign securities with no U.S. market, and the disclosure would not be relevant. Of course, if a customer were to request that the member provide a description of its policies and procedures with respect to the handling of foreign securities, FINRA would expect members to provide such information to ensure the customer fully understands the member’s handling of its

² Letter from David T. Bellaire, Esq., General Counsel & Director of Government Affairs, FSI, to Elizabeth M. Murphy, Secretary, SEC (Nov. 14, 2011).

order.³ However, FINRA does not believe it is necessary or appropriate to mandate notice in all cases for a subset of the member's policies and procedures.

FSI also suggests that FINRA include a requirement that members periodically review for compliance with the member's policies regarding foreign securities that do not trade in the U.S. Although FSI is correct that this is a requirement that members must observe, this requirement is true of all of a member's policies and procedures, not just those related to the handling of orders for foreign securities with no U.S. market.⁴ Under existing FINRA rules, a member is responsible for reviewing the conduct of its associated persons for compliance with both its policies and procedures and applicable laws and rules in all aspects of its business.⁵ Consequently, FINRA does not believe it is necessary to repeat this general obligation within a more limited context.

The final item FSI suggests adding to Supplementary Material .07 is a requirement that members periodically review their policies themselves to ensure that they meet the requirements of the rule. FINRA believes that the proposed Supplementary Material already sufficiently addresses this requirement. As proposed, the Supplementary Material notes that "best execution obligations also must evolve as changes occur in the market that may give rise to improved executions, including opportunities to trade at more advantageous prices." Consequently, the Supplementary Materials states that "members also must regularly review these policies and procedures to assess the quality of executions received and update or revise the policies and procedures as necessary." FINRA believes this language sufficiently addresses FSI's concern.

For the reasons set forth above, FINRA is not proposing amendments to Supplementary Material .07 based on FSI's comment letter. FINRA believes that the

³ In other contexts, including volatile market conditions, FINRA has encouraged members to educate retail customers regarding how they handle customer orders. *See, e.g., NASD Notice to Members 99-11* (Feb. 1999).

⁴ *See* NASD Rule 3010(a) ("Each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules.").

⁵ *See* NASD Rule 3010(b)(1) ("Each member shall establish, maintain and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD.").

Elizabeth M. Murphy
December 1, 2011
Page 4 of 4

foregoing responds to the material issues raised by FSI. If you have any questions, please feel free to contact me at (202) 728-6927.

Sincerely,

A handwritten signature in black ink that reads "Brant K. Brown". The signature is written in a cursive, flowing style.

Brant K. Brown

Associate General Counsel