

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-73632; File No. SR-FINRA-2014-046)

November 18, 2014

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Modify the Gross Income Assessment Pricing Structure

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 7, 2014, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. FINRA has designated the proposed rule change as “establishing or changing a due, fee or other charge” under Section 19(b)(3)(A)(ii) of the Act<sup>3</sup> and Rule 19b-4(f)(2) thereunder,<sup>4</sup> which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to modify the Gross Income Assessment pricing structure in Section 1(c) of Schedule A to the FINRA By-Laws.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>4</sup> 17 CFR 240.19b-4(f)(2).

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The proposed rule change is intended to provide limited relief from the Gross Income Assessment (“GIA”) for some smaller FINRA members due to the unanticipated effect of a 2009 change to the method of calculating the assessment. The GIA is one of a few primary revenue sources that funds FINRA’s regulatory operations<sup>5</sup> and is based on a firm’s annual gross revenue.<sup>6</sup> In 2008, FINRA established a seven-tier rate structure to assess the GIA, with a minimum assessment of \$1,200. The tiered rates, which have remained unchanged, are as follows:

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<sup>5</sup> FINRA’s primary member regulatory pricing structure also includes the Trading Activity Fee, the Personnel Assessment (“PA”) and the Branch Office Assessment, as well as the processing of new and continuing membership applications.

<sup>6</sup> Schedule A to the FINRA By-Laws defines gross revenue for assessment purposes as total income as reported on FOCUS form Part II or IIA, excluding commodities income.

- (1) \$1,200.00 on annual gross revenue up to \$1 million;
- (2) 0.1215% of annual gross revenue greater than \$1 million up to \$25 million;
- (3) 0.2599% of annual gross revenue greater than \$25 million up to \$50 million;
- (4) 0.0518% of annual gross revenue greater than \$50 million up to \$100 million;
- (5) 0.0365% of annual gross revenue greater than \$100 million up to \$5 billion;
- (6) 0.0397% of annual gross revenue greater than \$5 billion up to \$25 billion; and
- (7) 0.0855% of annual gross revenue greater than \$25 billion.

As a result of this structure, GIA revenues are derived overwhelmingly from medium-sized and larger firms. Due to rebates, firms with revenues of \$1 million or less effectively have paid no GIA since 2008.

In November 2009, the Commission approved changes to the GIA and PA intended to help FINRA achieve a more consistent and predictable funding stream to carry out its regulatory mandate.<sup>7</sup> The economic and industry downturns in 2008 and 2009 had exposed FINRA's vulnerability to year-to-year volatility in members' gross revenues. GIA revenues in 2009 dropped precipitously due to write-offs taken in late 2008, particularly by the largest securities firms.

To ameliorate this vulnerability and smooth out the volatility inherent in the GIA, FINRA amended Schedule A to base the GIA on the greater of (1) the tier rate applied to a member's annual gross revenue from the preceding calendar year ("current year GIA") or (2) a three-year average of GIA to be calculated by adding the current year GIA to the GIA assessed on the member in the previous two calendar years and dividing by three ("averaged GIA") (together

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<sup>7</sup> See Securities Exchange Act Release No. 61042 (November 20, 2009), 74 FR 62616 (November 30, 2009) (Order Approving File No. SR-FINRA-2009-057).

“the reformulated calculation”). Thus, the change was intended to maintain the GIA rate structure, while building a buffer against industry downturns.

While the reformulated calculation has been effective in stabilizing FINRA’s GIA revenues, an unanticipated impact of the new structure has been that firms can be locked in to a higher GIA as the result of a spike in gross revenue during a single year. The following example of a hypothetical Tier 2 firm illustrates the effect:

Year	Prior year assessable Gross FOCUS Revenue	GIA based on prior year revenue only	GIA based reformulated calculation (current rule)	Variance in GIA fee
2008	\$4 million	\$4,860	n/a	n/a
2009	\$4 million	\$4,860	n/a	n/a
2010	\$4 million	\$4,860	\$4,860	\$0
2011	\$10 million	\$12,150	\$12,150	\$0
2012	\$6 million	\$7,290	\$8,100	\$810
2013	\$4 million	\$4,860	\$8,370	\$3,510
2014	\$3 million	\$3,645	\$6,705	\$3,060

Thus, in years 2012 through 2014, the firm would be assessed an amount based on the average GIA that is significantly greater than the current GIA calculation, despite declining or flattening revenues during those years. This is due to the knock-on effect that the higher GIA fee in 2011 has created on the rolling three-year average calculations.

The original purpose of the previous rule change was to minimize the impact on FINRA revenues of down years suffered by mid-sized and large firms. FINRA had not contemplated the effect that intermittent significant increases in gross revenue could have on the GIA in subsequent years for smaller firms, where the relative impact can be greater. Accordingly, the proposed rule change would eliminate the averaged GIA component of the assessment

calculation where a firm's prior year gross revenue does not exceed \$25 million; i.e., those firms that fall within the lowest two tiers. In those circumstances, the firm would be assessed the current year GIA.

Based on 2013 FOCUS revenues, FINRA estimates that 87% (1,365) of the firms with revenues of \$25 million or less would benefit from the pricing change. FINRA further estimates that the change would result in savings to those firms of approximately \$3.5 million, or approximately 2.0% of total GIA revenue. FINRA found that the proposed assessment approach would have had similar impacts as applied to firm revenues in 2011 and 2012; in other words, the back tested impact is generally consistent for the past three years' worth of FOCUS data for active firms. FINRA notes that no firms would be worse off due to the pricing change. Since the current reformulated calculation assesses the greater of current year GIA or averaged GIA, the firms that would benefit from the change are those firms that have been subject to the higher averaged GIA. The remaining firms have paid only the current year GIA, which would continue under the proposed rule change, even if their revenues decrease.

FINRA recognizes this effect of averaging potentially affects all firms, so FINRA also considered the impact of eliminating the averaging component from the remaining tiers. Based on an analysis, FINRA found that a significantly lower number of firms with revenues in these higher revenue tiers were impacted by the averaging calculation. However, extending this pricing change to these firms would have a material financial impact on the funding of FINRA's regulatory program.

Therefore, FINRA is proposing to apply the modified pricing structure to firms that do not exceed the \$25 million tier. The relative negative impact of the current calculation falls disproportionately on those firms with gross revenues of \$25 million or less, while the revenue

impact on FINRA would be less at that threshold. At the same time, with a \$25 million threshold, the reformulated calculation that includes the averaged GIA would continue to apply to the largest concentration of firms with potentially significant year-to-year volatility in gross revenues.

FINRA has filed the proposed rule change for immediate effectiveness. FINRA is proposing that the implementation date of the proposed rule change will be January 1, 2015.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(5) of the Act,<sup>8</sup> which requires, among other things, that FINRA rules provide for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system that FINRA operates or controls. The Commission previously found both the current year GIA and the reformulated calculation to be an equitable allocation of reasonable fees.<sup>9</sup> FINRA believes the proposed modification to the GIA pricing structure remains reasonable, since it continues to apply either the current year GIA or the averaged GIA to all members and does not increase the assessment rates. FINRA also believes the proposed rule change retains an equitable allocation of fees, as it would continue to apply the reformulated calculation on members that accounted for approximately 98% of the revenue from GIA in 2013, while potentially lessening, under very particular circumstances, the assessment on members that accounted for only about 2% of revenue from the GIA. Furthermore, the proposed rule change is both reasonable and equitable with respect to the firms in the \$25 million tier, as

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<sup>8</sup> 15 U.S.C. 78o-3(b)(5).

<sup>9</sup> See Securities Exchange Release No. 57474 (March 11, 2008), 73 FR 14517 (March 18, 2008) (Order Approving File No. SR-FINRA-2008-001) and Securities Exchange Act Release No. 61042 (November 20, 2009), 74 FR 62616 (November 30, 2009) (Order Approving File No. SR-FINRA-2009-057).

no firm within that tier would be worse off. Instead, the proposed rule change would align those firms that have had to pay the higher averaged GIA with those firms that have only paid the current year GIA.

The GIA is predicated on the fact that larger firms individually require greater regulatory resources. The proposed rule change largely keeps in place a GIA pricing structure that, as the Commission noted in approving the reformulated calculation in SR-FINRA-2009-057, “is reasonable in that it achieves a generally equitable impact across FINRA’s membership and correlates the fees assessed to the regulatory services provided by FINRA.”<sup>10</sup>

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change would reduce the costs of approximately one-third of FINRA members. As described in Item II.A. above, FINRA considered various thresholds for applying the modified GIA pricing structure to strike the appropriate balance between providing limited relief to smaller firms negatively impacted by the current GIA calculation, while maintaining a pricing structure that adequately supports its regulatory programs and minimizes revenue volatility.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments were neither solicited nor received.

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<sup>10</sup> See supra note 9.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>11</sup> and paragraph (f)(2) of Rule 19b-4 thereunder.<sup>12</sup> At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2014-046 on the subject line.

#### Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-FINRA-2014-046. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

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<sup>11</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>12</sup> 17 CFR 240.19b-4(f)(2).



comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer

to File Number SR-FINRA-2014-046 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>13</sup> 17 CFR 200.30-3(a)(12).