

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59788; File No. SR-FINRA-2007-024)

April 17, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to Amendments Involving Best Execution and Interpositioning

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on November 27, 2007, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. On April 13, 2009, FINRA filed Amendment No. 1 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

FINRA is proposing to amend NASD Rule 2320 to update members’ best execution obligations involving interpositioning and to amend NASD Rule 3110(b), NASD IM-2320, and FINRA Rule 6635 to reflect the redesignation of certain paragraphs in NASD Rule 2320.

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

NASD Rule 2320(b) (the "Interpositioning Rule") requires that, when interposing a third party between a member and the best available market for a security, the member must show that the total cost or proceeds of the transaction were better than the prevailing inter-dealer market. Accordingly, it is a violation of the Interpositioning Rule if a member interposes a third party and the total cost of the transaction is equal to or greater than that of the prevailing inter-dealer market or the total proceeds of the transaction were equal to or less than that of the prevailing inter-dealer market.

Although unclear from the legislative history of the Interpositioning Rule, it appears that the intent of requiring a "better than" standard, rather than an "equal to" standard, was to deter members from interposing a third party in transactions that should be sent directly to a market maker.³ Since the adoption of the Interpositioning Rule in 1968, there have been substantial

³ In the mid-1980s, as part of extensive amendments to NASD rules, several changes to the Interpositioning Rule were proposed but never adopted. See NASD Notice to Members 89-20 (February 17, 1989); NASD Notice to Members 86-9 (February 7, 1986). One of the proposed changes, which is similar to the current proposed rule change, would have prohibited interpositioning unless a member could demonstrate that the price paid or received by the customer was "better than or equal to" the prevailing inter-dealer price.

changes to the ways in which markets function, including technological advances, increased market transparency in the equities markets, and the development of electronic communication networks and order routing services. These changes enable firms, under certain circumstances, to use intermediaries and third parties to improve the handling of orders with no additional cost to the customer. Firms are now frequently able to send an order to a third party with minimal or no delay in the execution of the customer's order and with no additional cost to the customer. In addition, there are occasions when the use of a third party may be necessary to effectuate the execution of an order. For example, a firm may need to involve a third party if it receives an order for a foreign security that may not trade in the United States and the firm lacks the ability to execute the order without involving another broker-dealer. The language of the Interpositioning Rule could be read to include such circumstances, even if the customer incurs no additional cost or the cost is necessary to effectuate the trade. FINRA believes that the current language of the Interpositioning Rule does not reflect the reality of recent technological advances in order handling and that the rule could be read to prohibit conduct that does not adversely affect the customer and, in some cases, benefits the customer.

The proposed rule change is intended to address the potential overbreadth of the current Interpositioning Rule while making clear that interpositioning third parties in a way that results in customer harm is still prohibited. The proposed rule change would replace the current Interpositioning Rule with a more general statement that the factors enumerated in Rule 2320(a) apply to those situations contemplated by the Interpositioning Rule (i.e., orders routed to third

One commenter to that proposal, the Securities Industry Association, which merged with the Bond Market Association to form the Securities Industry and Financial Markets Association, supported the proposal, noting that if a member deems it advantageous for legitimate business reasons to buy or sell a security from a non-market maker and the customer receives a price equal to the inter-dealer price, the customer would not be prejudiced.

parties between a member and the best available market). Rule 2320(a) states that members and persons associated with a member must use reasonable diligence to ascertain the best market for a security when handling transactions for or with a customer or a customer of another broker-dealer. Among the factors to be considered in determining whether a member has used reasonable diligence to ascertain the best market for a security, are: (1) the character of the market for the security, e.g., price, volatility, relative liquidity, and pressure on available communications; (2) the size and type of transaction; (3) the number of markets checked; (4) accessibility of the quotation; and (5) the terms and conditions of the order which result in the transaction, as communicated to the member and persons associated with the member. In addition, Rule 2320(a) requires members and persons associated with a member to buy or sell in the best market “so that the resultant price to the customer is as favorable as possible under prevailing market conditions.”

Rather than focusing exclusively on cost, as the current Interpositioning Rule does, the proposed rule change would apply the standards in Rule 2320(a) to the execution of all orders, including those involving interposed third parties. Thus, although the cost (or, as phrased in 2320(a), the resultant price) to a customer would remain a crucial factor in determining whether a member has fulfilled its best execution obligations under Rule 2320, particularly in the context of retail customer order executions, the proposed rule change would allow an analysis of a variety of factors, based on the terms of the customer’s order and instructions, rather than focusing solely on cost any time a member interposes a third party between the member and the best available market for a security.⁴ However, interpositioning that is unnecessary or violates a

⁴ A member’s best execution obligations under NASD Rule 2320 require a member to buy or sell a security in the best market for the subject security “so that the resultant price to the customer is as favorable as possible under prevailing market conditions.” However, other FINRA rules also apply when handling customer orders. For example, NASD Rule

member's general best execution obligations – either because of unnecessary costs to the customer or improperly delayed executions – would still be prohibited.

The effective date of the proposed rule change will be the date of Commission approval. FINRA will announce the approval in a Regulatory Notice within 30 days following Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁵ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will allow for a determination of best execution to be based on all of the facts and circumstances surrounding an order rather than a singular focus on one aspect of the transaction.

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.

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.

2440 and FINRA Rule 2010 prohibit members from charging customers more than a fair commission or service charge, taking into consideration all relevant circumstances. If a member interposes a third party that charges a commission or service charge, the member must ensure that the total resulting commissions or service charges paid by the customer are fair. Consequently, unnecessarily interposing a third party in a transaction and passing on to a customer a fee charged by that third party would violate NASD Rule 2440 and FINRA Rule 2010.

⁵ 15 U.S.C. 78o-3(b)(6).

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be 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. Please include File Number SR-FINRA-2007-024 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2007-024. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<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 inspection and copying 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 publicly available. All submissions should refer to File Number SR-FINRA-2007-024 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.⁶

Florence E. Harmon
Deputy Secretary

⁶ 17 CFR 200.30-3(a)(12).