

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60330; File No. SR-FINRA-2009-044)

July 17, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 2262 (Disclosure of Control Relationship with Issuer), 2269 (Disclosure of Participation or Interest in Primary or Secondary Distribution) and 5260 (Prohibition on Transactions, Publication of Quotations, or Publication of Indications of Interest During Trading Halts) in the Consolidated FINRA Rulebook

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 June 29, 2009, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) 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. 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 adopt without material change NASD Rules 2240 (Disclosure of Control Relationship with Issuer), 2250 (Disclosure of Participation or Interest in Primary or Secondary Distribution) and 3340 (Prohibition on Transactions, Publication of Quotations, or Publication of Indications of Interest During Trading Halts) as FINRA rules in the Consolidated FINRA Rulebook and to delete NYSE Rules 312(f)(1) through 312(f)(3) and 321.24. The proposed rule change would renumber

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

NASD Rules 2240, 2250 and 3340 as FINRA Rules 2262, 2269 and 5260, respectively, in the Consolidated FINRA Rulebook.

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.

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

As part of the process of developing a new consolidated rulebook ("Consolidated FINRA Rulebook"),³ FINRA is proposing to adopt without material change NASD Rules 2240 (Disclosure of Control Relationship with Issuer), 2250 (Disclosure of Participation or Interest in Primary or Secondary Distribution) and 3340 (Prohibition on Transactions,

³ The current FINRA rulebook consists of: (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE ("Incorporated NYSE Rules") (together, the NASD Rules and Incorporated NYSE Rules are referred to as the "Transitional Rulebook"). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE ("Dual Members"). The FINRA Rules apply to all FINRA member firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process).

Publication of Quotations, or Publication of Indications of Interest During Trading Halts) as FINRA rules in the Consolidated FINRA Rulebook and to delete NYSE Rules 312(f)(1) through 312(f)(3) and 321.24. The proposed rule change would renumber NASD Rules 2240, 2250 and 3340 as FINRA Rules 2262, 2269 and 5260, respectively, in the Consolidated FINRA Rulebook.

(A) Proposed FINRA Rules 2262 and 2269

(1) Background

Both NASD and NYSE Rules⁴ address disclosures or notifications that member firms must provide to customers in connection with certain securities transactions.

NASD Rules 2240 and 2250 set forth requirements that apply to transactions with or for a customer in any market.⁵ In short:

- Disclosure of control relationship: NASD Rule 2240 provides that a member controlled by, controlling, or under common control with the issuer of any security must, before entering into any contract with or for a customer for the purchase or sale of such security, disclose to the customer the existence of such control; if such disclosure is not made in writing, it must be

⁴ For convenience, the Incorporated NYSE Rules are referred to as the “NYSE Rules.”

⁵ NASD Rules 2240 and 2250 (formerly designated, respectively, as Sections 13 and 14 of the Rules of Fair Practice) were adopted in 1939 as part of FINRA’s original rulebook. See Certificate of Incorporation and By-Laws, Rules of Fair Practice and Code of Procedure for Handling Trade Practice Complaints of National Association of Securities Dealers, Inc. (August 8, 1939). The requirements of NASD Rules 2240 and 2250 duplicate almost word-for-word SEA Rules 15c1-5 (Disclosure of Control) and 15c1-6 (Disclosure of Interest in Distributions), respectively. See Securities Exchange Act Release No. 1330 (August 4, 1937) (“Release No. 1330”).

supplemented by written disclosure at or before the completion of the transaction;⁶

- Disclosure of participation or interest in distribution: Rule 2250 provides that if a member is acting as a broker for a customer, or is acting for both the customer and some other person, or is acting as a dealer and receives or has promise of receiving a fee from a customer for advising the customer with respect to securities, then the member must, at or before the completion of any transaction for or with the customer in any security in the primary or secondary distribution of which the member is participating or is otherwise financially interested, give the customer written notification of the existence of such participation or interest.⁷

NYSE Rules 312(f)(2) and 321.24 address disclosures or notifications to customers in somewhat different fashion than NASD Rules 2240 and 2250:

- NYSE Rule 312(f)(2) is similar to NASD Rule 2240, except that Rule 312(f)(2)'s requirement to disclose the control relationship between the issuer and the member is triggered in the context of making a recommendation to a customer. Specifically, Rule 312(f)(2) requires that any member organization

⁶ SEA Rule 15c1-5 defines “manipulative, deceptive, or other fraudulent device or contrivance,” as used in Section 15(c)(1) of the Exchange Act, to include failure to provide the required disclosure. Section 15(c)(1) provides, in part, that no broker or dealer “shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security . . . otherwise than on a national securities exchange of which it is a member . . . by means of any manipulative, deceptive, or other fraudulent device or contrivance.” See also Release No. 1330.

⁷ Under SEA Rule 15c1-6, like Rule 15c1-5, failure to provide the required notification is a fraudulent act. Rule 15c1-6, like Rule 15c1-5, is limited by the scope of Section 15(c)(1) of the Exchange Act. See supra note 6.

⁸) must

promptly disclose to the customer the existence and nature of such control at the time of recommendation and, if the disclosure is not made in writing, must provide it in writing prior to the completion of the transaction;⁹

- NYSE Rule 321.24, like NASD Rule 2250, requires disclosure of interest in securities, except that the provisions of Rule 321.24 apply in contexts involving securities underwritten, distributed or sold by a subsidiary of the member. Specifically, Rule 321.24 requires that, in connection with any transactions which the member or member organization may have had with its customers, or any recommendation which the member or member organization may make to its customers, involving securities underwritten, distributed or sold by the subsidiary, full disclosure must be made by the

⁸ The indicia for determining status as a Material Associated Person are set forth in SEA Rule 17h-1T(a)(2). See NYSE Rule 312(f)(1).

⁹ Note that NYSE Rules 312(f)(1), (f)(2) and (f)(3) were, prior to revisions adopted in 2006, combined together as former Rule 312(f). NYSE Rule 312(f)(1) prohibits member organizations, after completion of a distribution, from effecting any transaction (except on an unsolicited basis) for the account of any customer in the equity or non-investment grade debt of the member organization itself, any parent entity, or any Material Associated Person. Rule 312(f)(3), among other things, requires a member corporation with publicly held securities outstanding to obtain the NYSE's approval to acquire such securities for its own account or the account of any corporation controlling, controlled by or under common control with the member corporation. The rule provides that the NYSE will approve such acquisition unless it determines that such action will impair the financial responsibility or operational capability of the member corporation. For further discussion of NYSE Rule 312(f), see NYSE Information Memo 06-65 (September 11, 2006).

member or member organization to its customers of the interest of the subsidiary in the securities at that time.

(2) Proposal

FINRA proposes to transfer NASD Rules 2240 and 2250 unchanged into the Consolidated FINRA Rulebook. Though the substantive requirements of both rules are duplicated, almost word-for-word, in SEA Rules 15c1-5 and 15c1-6, the two NASD rules provide broad protection to customers because their scope extends to transactions with or for a customer in any market, not just over-the-counter transactions.

FINRA proposes to repeal NYSE Rules 312(f)(1) through (f)(3) and 321.24 because the purposes they serve are addressed by proposed FINRA Rules 2262 and 2269, other existing or proposed FINRA rules, and SEC rules. With respect to NYSE Rule 312(f)(1), FINRA notes that making a recommendation or effecting a transaction such as set forth in the rule raises concerns that are within the purview of current anti-manipulation rules (e.g., FINRA Rule 2020 and SEA Rule 10b-5). Further, FINRA notes that customers would be protected by the disclosure that the proposed rules require with respect to the conflicts of interest that the NYSE rule addresses. Moreover, members must comply with FINRA's suitability rule when recommending securities transactions to their customers. With respect to NYSE Rule 312(f)(2), FINRA notes that the proposed FINRA rules would operate to protect customers without regard to whether a member recommends a security to a customer. With respect to NYSE Rule 312(f)(3), FINRA believes that the customer protections provided by the proposed rules and the anti-manipulation rules, in combination, would render the NYSE rule redundant. Further, FINRA maintains a set of rules specifically addressing financial responsibility

requirements for members and is separately proposing to adopt consolidated financial responsibility rules.¹⁰ Lastly, with respect to NYSE Rule 321.24, FINRA notes that the disclosure required by the proposed FINRA rules is not limited to situations involving securities underwritten, distributed or sold by a member's subsidiary.

(B) Proposed FINRA Rule 5260

(1) Background

NASD Rule 3340 prohibits members from, directly or indirectly, effecting transactions or publishing quotations or indications of interest (“IOIs”) in (1) any security with respect to which a trading halt is in effect; or (2) any security future when there is a regulatory trading halt in effect with respect to the underlying security.

The trading and quoting conduct prohibited by Rule 3340 is triggered only when a trading halt is in effect. The rule also provides that, in the event that FINRA halts over-the-counter trading and quoting in NMS stocks because the Alternative Display Facility (“ADF”) or a Trade Reporting Facility (“TRF”) is unable to transmit real-time information to the applicable Securities Information Processor, members are not prohibited from trading through other markets for which trading is not halted.

NASD Rule 3340 was originally approved by the SEC in 1988.¹¹ The rule was subsequently amended in 2001, 2002, 2003 and 2006. The 2001 amendments expressly prohibited members from publishing quotations and IOIs during a trading halt (the rule in its form prior to the 2001 amendments prohibited members from effecting a transaction

¹⁰ See, e.g., Securities Exchange Act Release No. 59273 (January 22, 2009), 74 FR 4992 (January 28, 2009) (Notice of Filing File No. SR-FINRA-2008-067).

¹¹ NASD Rule 3340 was originally adopted as Section 42 of Article III of the Rules of Fair Practice.

but did not expressly address quotations and IOIs).¹² The 2002 and 2006 amendments to Rule 3340 provided that, if the ADF or a TRF were unable to transmit real-time information to the applicable Securities Information Processor, members would not be prohibited from trading through other markets for which trading is not halted.¹³ The 2003 amendments to the rule added a provision to prohibit member firms, including Alternate Trading Systems (“ATs”), from trading or publishing quotes or IOIs in any security future when a regulatory trading halt is in effect with respect to the underlying security. Specifically, Rule 3340 was amended to apply to a future for a single security when a regulatory trading halt is in effect for the underlying security or a future on a narrow-based securities index when a regulatory trading halt is in effect for one or more underlying securities that constitute 50% or more of the market capitalization of the index.¹⁴

In 2002, FINRA published a set of frequently asked questions in response to members’ requests for guidance on the application of NASD Rule 3340 to particular scenarios.¹⁵

¹² See Securities Exchange Act Release No. 44390 (June 5, 2001), 66 FR 31262 (June 11, 2001) (Order Approving File No. SR-NASD-2000-33).

¹³ See Securities Exchange Act Release No.46249 (July 24, 2002), 67 FR 49822 (July 31, 2002) (Order Approving File No. SR-NASD-2002-97) (approving the 2002 amendments to NASD Rule 3340); Securities Exchange Act Release No. 54084 (June 30, 2006), 71 FR 38935 (July 10, 2006) (Order Approving File No. SR-NASD-2005-087) (approving the 2006 amendments to NASD Rule 3340).

¹⁴ See Securities Exchange Act Release No. 47259 (January 27, 2003), 68 FR 5319 (February 3, 2003) (Order Approving File No. SR-NASD-2001-047).

¹⁵ See NASD Notice to Members 02-82 (December 2002) (Frequently Asked Questions Relating to Trading Halts).

(2) Proposal

FINRA believes that Rule 3340 is well understood by its members and has proven effective. Accordingly, FINRA proposes that the rule be transferred without material change into the Consolidated FINRA Rulebook as FINRA Rule 5260.¹⁶

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 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,¹⁷ 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 would further the purposes of the Act because, as part of the Consolidated FINRA Rulebook, the proposed rule change will protect investors and the public interest by addressing disclosures or notifications in connection with certain securities transactions and by addressing certain trading and quoting conduct when a trading halt is in effect.

¹⁶ On December 30, 2008, FINRA filed with the SEC a proposed rule change to amend NASD Rule 3340 to create a limited exception to permit members to route unsolicited customer orders for execution outside the United States while a trading halt is in effect in the United States. See SR-FINRA-2008-069. Assuming Commission approval of this proposed rule change prior to Commission approval of SR-FINRA-2008-069, FINRA will amend SR-FINRA-2008-069, as necessary, to reflect such approval. Similarly, in the event the Commission approves SR-FINRA-2008-069 prior to approval of this proposed rule change, FINRA will amend this proposed rule change, as necessary, to reflect such approval.

¹⁷ 15 U.S.C. 78q-3(b)(6).

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.

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-2009-044 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-2009-044. 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 a.m. and 3 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-2009-044 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.¹⁸

Florence E. Harmon
Deputy Secretary

¹⁸ 17 CFR 200.30-3(a)(12).