

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-60850; File No. SR-FINRA-2009-067)

October 21, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 2060 (Use of Information Obtained in Fiduciary Capacity) and 5290 (Order Entry and Execution Practices) in the Consolidated FINRA Rulebook

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 October 6, 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 NASD Rules 3120 (Use of Information Obtained in Fiduciary Capacity) and 3380 (Order Entry and Execution Practices) as FINRA rules in the consolidated FINRA rulebook without material change. The proposed rule change would renumber NASD Rule 3120 as FINRA Rule 2060 and NASD Rule 3380 as FINRA Rule 5290 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.

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

<sup>2</sup> 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

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”),<sup>3</sup> FINRA is proposing to adopt NASD Rules 3120 and 3380 in the Consolidated FINRA Rulebook without material change as FINRA Rules 2060 and 5290 respectively.

Proposed FINRA Rule 2060

FINRA is proposing to adopt NASD Rule 3120 as FINRA Rule 2060 in the Consolidated FINRA Rulebook. NASD Rule 3120 provides that a member who receives information as to the ownership of securities while acting in the capacity of paying agent, transfer agent, trustee or otherwise shall under no circumstances make use of the information for soliciting purchases, sales or exchanges except at the request and on behalf of the issuer. Rule 3120, formerly

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<sup>3</sup> 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 members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see Information Notice, March 12, 2008 (Rulebook Consolidation Process).

designated as Article III, Section 9 of the Rules of Fair Practice, was adopted as part of FINRA's original rulebook.<sup>4</sup> The text of the rule has not been amended since its inception.

FINRA believes that the rule serves an important purpose by prohibiting a member, while acting in the capacity of paying agent, transfer agent, trustee or otherwise, from using certain information it obtains about the ownership of securities to solicit purchases, sales or exchanges except at the request and on behalf of the issuer.<sup>5</sup>

#### Proposed FINRA Rule 5290

FINRA is proposing to adopt NASD Rule 3380 as FINRA Rule 5290 in the Consolidated FINRA Rulebook. NASD Rule 3380 prohibits members and associated persons from splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind payment to the member or associated persons as a result of the execution of such orders or the transaction reporting of such executions.<sup>6</sup> For purposes of the rule, "monetary or in-kind

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<sup>4</sup> 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).

<sup>5</sup> With respect to the exception allowing use of information at the request and on behalf of the issuer, the descriptive analysis of the identical precursor provision drafted by the Investment Bankers Code Committee in 1934 explains that the exception is provided

because if the issuer desires either to refund or propose an exchange to the security holder, he certainly has the right to demand from his transfer agent or trustee the list of security holders and the issuer thus being in a position to address them directly, the investment banker should be able to address them on his behalf.

See Code Of Fair Competition For Investment Bankers With A Descriptive Analysis Of Its Fair Practice Provisions And A History Of Its Preparation (1934).

<sup>6</sup> This is commonly also referred to as "trade shredding," which is the unlawful practice of splitting customer orders for securities into multiple smaller orders (e.g., a 1,000 share

amount” is defined to include, but not be limited to, any credits, commissions, gratuities, payments for or rebates of fees, or any other payments of value to the member or associated person. The SEC approved NASD Rule 3380 in February 2006 after notice and comment with no subsequent amendments.<sup>7</sup>

FINRA is proposing to replace “may” with “shall” in the rule text, but believes no substantive changes to this rule are appropriate or necessary.<sup>8</sup> FINRA continues to believe that NASD Rule 3380 is necessary and appropriate to deter the distortive practice of trade shredding.<sup>9</sup>

As noted above, 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

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order is split into ten 100 share orders) for the primary purpose of maximizing payments or rebates to the member.

<sup>7</sup> See Securities Exchange Act Release No. 53371 (February 24, 2006), 71 FR 11008 (March 3, 2006) (Order Approving File No. SR-NASD-2005-144).

<sup>8</sup> See Exhibit 5 (“No member or associated person [may] shall engage in conduct that has the intent or effect of splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind amount to be received by the member or associated person as a result of the execution of such orders or the transaction reporting of such executions”).

<sup>9</sup> FINRA also notes that the rule is consistent with the rules of other securities self-regulatory organizations regarding trade shredding. See, e.g., NYSE Rule 123G (Order Entry Practices) approved pursuant to Securities Exchange Act Release No. 52683 (October 26, 2005), 70 FR 66480 (November 2, 2005) (Order Approving File No. SR-NYSE-2005-62).

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>10</sup> 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 continues to believe that, in certain circumstances, a rule prohibiting members from using information about ownership of securities to solicit purchases, sales or exchanges except at the request and on behalf of the issuer serves to protect investors and the public interest. In addition, FINRA continues to believe that a rule regarding order entry and execution practices will continue to further the goal of preventing manipulative acts and practices by prohibiting the potentially distortive practice of trade shredding.

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

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<sup>10</sup> 15 U.S.C. 78q-3(b)(6).

(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](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2009-067 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-2009-067. 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 the 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-2009-067 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>11</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>11</sup> 17 CFR 200.30-3(a)(12).