

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61042; File No. SR-FINRA-2009-057)

November 20, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Granting Approval of a Proposed Rule Change Relating to Section 1(c) of Schedule A to the FINRA By-Laws to Amend the Personnel Assessment and Gross Income Assessment

I. Introduction

On August 20, 2009, Financial Industry Regulatory Authority, Inc. (“FINRA”) (formerly known as the National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder² to amend Section 1(c) of Schedule A to the FINRA By-Laws (“Schedule A”) to increase the Personnel Assessment and to revise the formulation of the Gross Income Assessment calculation to be paid by each FINRA member. The proposed rule change was published for comment in the Federal Register on September 11, 2009.³ The Commission received 745 comment letters on the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 60624 (September 3, 2009), 74 FR 46828 (September 11, 2009) (“Notice”).

proposal.⁴ FINRA submitted a response to the comment letters on November 18, 2009.⁵ This order approves the proposal.

II. Description of FINRA's Proposal

Currently, FINRA's primary fee structure to support its regulatory programs consists of the following fees: the Personnel Assessment ("PA"); the Gross Income Assessment ("GIA"); the Trading Activity Fee; and the Branch Office Assessment. These fees are used to fund FINRA's regulatory activities, including rulemaking and FINRA's examination and enforcement programs. According to FINRA, the economic and industry downturns experienced in 2008 and 2009 have strained FINRA's resources, yet its regulatory responsibilities remain constant and its programs robust. To stabilize its revenues and provide protection against future industry downturns, FINRA proposes to increase the PA and revise the calculation of the GIA. This will enable FINRA to achieve a more consistent and predictable funding stream to carry out FINRA's regulatory mandate.

To those ends, the proposed rule change will increase the PA for all members. The PA currently is assessed on a three-tiered rate structure based on the number of the firm's registered representatives and principals ("registered persons") as follows: members with one to five registered persons are assessed \$75 for each such registered person; 6-25 registered persons, \$70 for each such registered person; and 26 or more registered persons, \$65 for each such registered

⁴ 676 of the letters were form comment letters. Of these, four utilized "Letter Type A" and 672 utilized "Letter Type B." An example of Letter Type A and Letter B as well as all of the non-form comment letters are posted on the Commission's Internet Web site (<http://www.sec.gov/comments/sr-finra-2009-057/finra2009057.shtml>). See Exhibit 1 for a list of comment letters noted on the Commission's Internet Web site. All 745 comment letters are available for inspection and copying at the Commission's Public Reference Room.

⁵ See letter from Phillip Shaikun, Associate Vice President and Associate General Counsel, FINRA, to Elizabeth M. Murphy, Secretary, Commission, dated November 18, 2009. ("Response Letter").

person. The proposed rule change will increase those rates, for the first time in five years, to \$150, \$140, and \$130, respectively, based on the same tiered structure. FINRA notes that there is a correlation between the cost of FINRA's regulatory programs and the number of registered persons within a firm and that the population of registered persons has remained fairly stable, even throughout the recent economic downturn.⁶ Accordingly, FINRA believes that an increase of the PA is both a fair and appropriate means to achieve a more consistent and reliable foundation to fund its regulatory operations.

FINRA states that even with the proposed increase of the PA, the GIA remains the most important component of FINRA's regulatory funding. The GIA is currently assessed through a seven-tier rate structure with a minimum GIA of \$1,200.00. Under the existing GIA rate structure, members are required to pay an annual GIA as follows:

- (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.

For 2010, the current year GIA will be subject to the cap set forth in Regulatory Notice 08-07 (February 2008), which describes the funding structure that resulted from the consolidation of NASD's and the New York Stock Exchange's member regulation operations.

⁶ For example, FINRA records show that since 2000, the average number of registered persons per year has been approximately 667,680 and that for each of the past three years the population has been 669,626 (2009), 676,927 (2008) and 662,742 (2007) (based on numbers at the end of the preceding calendar year).

FINRA states in Regulatory Notice 08-07 that it will apply a 10% cap on any increase or decrease to a firm's 2010 current year GIA⁷ resulting from the new pricing structure implemented in January 2008.

According to FINRA, since the GIA is assessed based on a member's annual gross revenue for the preceding calendar year,⁸ FINRA's revenues derived from the GIA are subject to the year-to-year volatility of member revenues. In years when industry revenues are significantly lower, FINRA's operating revenues can drop precipitously. In 2009, for example, GIA revenues are down by approximately 37% compared to 2008 due to 2008 fourth quarter write-offs taken by members, particularly the largest securities firms.

The proposed rule change seeks to ameliorate this vulnerability not only by shifting some of FINRA's revenue generation to the more consistent PA stream, but also by smoothing out the volatility inherent in the GIA. To that end, the proposed rule change will amend Schedule A to assess a GIA that is the greater of: (1) the amount that will be the GIA based on the existing rate structure ("current year GIA"); or (2) a three-year average of the GIA to be calculated by adding the current year GIA plus the GIA assessed on the member over the previous two calendar years, divided by three. For a newer firm that has been assessed only in the prior year, FINRA will compare the current year GIA to the two-year average and assess the greater amount. The

⁷ "2010 current year GIA" means the amount of GIA assessment due under the proposed new formulation. However, if 2010 current year GIA represents an increase or decrease of more than 10% compared to 2009 current year GIA, the increase or decrease will be capped at 10%.

⁸ Gross revenue for assessment purposes is set out in Section 2 of Schedule A, which defines gross revenue as total income as reported on FOCUS form Part II or IIA excluding commodities income.

existing GIA rate structure and phase-in implementation through 2010 will remain the same.⁹ Accordingly, the proposed rule change will preserve the current rate structure, while building a buffer against industry downturns. FINRA notes that it has a long history of providing rebates to members when revenues exceed the expenditures necessary to discharge its regulatory obligations and is committed to continuing that practice in the future.

FINRA believes that the proposed rule change will stabilize its operating cash flows by augmenting revenues based on the registered person population (on which FINRA's costs are more closely aligned) and reducing dependency on, and exposure to, less predictable industry revenues. FINRA estimates that, if the proposed rule change had been in effect for 2009, it would have replaced about 90% of the revenue shortfall that resulted primarily from the significant drop in GIA revenues. FINRA notes that, in general, those replacement revenues will come from several larger firms whose steep income declines in 2008 primarily account for FINRA's current revenue deficit.

FINRA intends to announce the proposed rule change and its approval by the Commission in a Regulatory Notice. The proposed rule change will become effective January 1, 2010.

III. Discussion of Comments and Commission Findings

The Commission received 676 form comment letters, and 69 individual comment letters, regarding this proposal. FINRA responded to the comment letters on November, 18, 2009.¹⁰ After careful review of the proposal and consideration of the comment letters and the Response Letter, the Commission finds, for the reasons discussed below, that the proposed rule change is

⁹ The actual amount of GIA assessed in any given year, e.g., the current year GIA (including a cap, if applicable) or the three-year average, will be used to calculate subsequent three-year average determinations.

¹⁰ See Response Letter, supra note 5.

consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.¹¹ In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(5) of the Act,¹² which requires, among other things, that FINRA's 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 which the association operates or controls.

The commenters object to FINRA's fee proposal primarily for the following reasons: (1) FINRA should have anticipated the market downturn and budgeted accordingly; (2) the proposed assessment increases are unreasonable in light of the difficult economic times for the industry and fee increases imposed by other entities, including regulators and market operators; (3) the percentage increase of the PA is too steep and out of step with inflation; and (4) the proposed increases will disproportionately impact small and independent broker-dealers that were not responsible for FINRA's revenue shortfalls. Some commenters question whether the proposed rule change meets the statutory requirements of Section 15A(b)(5) of the Act. Several commenters offer alternative approaches to the proposed changes to the PA and GIA fees, including: implementing caps on the PA and GIA increases; implementing a phase-in period for the PA and GIA increases; reversing the volume discount structure for the PA assessment; and using a three-year GIA average instead of the proposed higher of actual year GIA or the three-year GIA average.

As an initial matter, the Commission notes that, as a national securities association, FINRA is obligated to be so organized and to have the capacity to be able to carry out the

¹¹ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78q-3(b)(5).

purposes of the Act and (subject to any rule or order of the Commission pursuant to Section 17(d) or 19(g)(2) of the Act)¹³ to enforce compliance by its members and persons associated with its members, with the provisions of the Act, and rules and regulations thereunder, and FINRA's own rules.¹⁴ Adequate regulatory funding is critical to FINRA's ability to meet these statutory requirements.

While some member firms understandably question whether it is reasonable for FINRA to increase regulatory fees at a time when the securities industry has faced declining revenues as a result of the economic downturn, it is incumbent on FINRA to continue to support a robust regulatory program irrespective of market events. The discussion below addresses the significant issues raised by the commenters, FINRA's response to those comments, and the Commission's views with respect to those issues.

A. PA Increase is Equitable

Currently, FINRA member firms are charged annually per registered person at the following rates: firms with up to five registered persons pay \$75 for each such person; firms with between 6-25 registered persons pay \$70 for each such person (a 6.7% discount from \$75); firms with over 25 registered persons pay \$65 for each person (a 13.3% discount from \$75). The proposal will increase the rates to \$150, \$140 (a 6.7% discount from \$150), and \$130 (a 13.3% discount from \$150), respectively. While most commenters, including the 672 Form B commenters, state specifically that the GIA assessment changes unfairly burden small independent broker-dealers,¹⁵ some commenters note in general that any increase in fees, including the PA increase, unfairly burdens independent broker-dealers, especially in the current

¹³ See 15 U.S.C. 78q(d) and 15 U.S.C. 78s(g)(2).

¹⁴ 15 U.S.C. 78o-3(b)(2).

¹⁵ The issue of whether the GIA fee revision is equitable is addressed in Section III.C. infra.

economic climate.¹⁶ One of these commenters advocates for a reversal of the discount structure, noting that FINRA should offer per person discounts to the smallest firms instead of the largest firms, to remedy the alleged inequities.¹⁷ Another commenter argues that the number of representatives is not necessarily a better indicator of FINRA resources consumed than overall income.¹⁸ This commenter advocates for a more complex PA structure with additional tiers and possible differentiation of PA rates based on the activity that the registered representative conducts, e.g., a higher PA rate for Series 7 registered representatives than for Series 6. Another commenter supports placing a limit on the annual percentage increase in the PA to ten percent, if the PA increase is approved.¹⁹ This commenter favors a fee structure in which firms engaging in higher-risk activities would be subject to higher fees.

The Commission notes that the current three-tiered PA structure, including the discount percentages, was found to be consistent with the Act and was approved by the Commission nearly seven years ago.²⁰ The proposed increase to the PA will not change the three-tiered structure of the PA or the level of the discount percentages for larger firms. Also, the manner of allocation of the PA fee among FINRA members will remain unchanged. Moreover, viewing the increase in absolute dollar terms, FINRA estimates that the average increase in total PA fees for firms with 100 or fewer registered persons, a population that constitutes 4,074 out of 4,868, or nearly 84%, of FINRA firms, will amount to approximately \$1,000 per firm, whereas the largest

¹⁶ See, e.g., First Independent Letter, Financial Network Letter, Form Letter B, Sykes Financial Letter, and Whitestone Letter, infra in Exhibit 1.

¹⁷ See Abel Noser Letter, infra in Exhibit 1.

¹⁸ See State Farm Letter, infra in Exhibit 1.

¹⁹ See MetLife Letter, infra in Exhibit 1.

²⁰ See Securities Exchange Act Release No. 47106 (December 30, 2002), 68 FR 819 (January 7, 2003) (NASD-2002-99) (order approving current PA fee structure).

100 firms (based on the number of registered persons as of year end 2008) will experience an average increase of approximately \$300,000.²¹ Lastly, as FINRA notes, the number of registered representatives is a significant factor that impacts FINRA's oversight responsibilities and thus is an equitable criterion for assessing PA fees.²² Therefore, additional tiers and/or differentiation based on Series 6 or Series 7 or other criteria is not necessarily a better solution. The Commission finds that the PA increase based on the current three-tiered PA fee structure is an equitable allocation of fees.²³

B. PA Increase is Reasonable

735 commenters argue that a 100% increase in annual PA fees is an unreasonably large increase.²⁴ Many commenters note that an increase of 100% is not commensurate with the rate of inflation over the past five years and, in general, is not justified.²⁵ FINRA responds to these comments by stating that assessing the proposed fee change in percentage terms and measuring it against an inflation benchmark such as the Consumer Price Index is not the proper method of analysis.²⁶ FINRA contends that the proper measure of reasonableness is arrived at by

²¹ See Response Letter, supra note 5 at page 6.

²² In 2008, FINRA conducted 4,924 oversight and cause examinations. These examinations, in large part, focused on broker-dealer conduct and activity involving interaction with customers. As result, in that year, FINRA brought 586 formal disciplinary actions against registered representatives and an additional 115 formal actions against member firms for failing to supervise their employees. See Response Letter, supra note 5 at page 6.

²³ A discussion of the appropriateness of a PA fee increase given these economic circumstances follows in Section III.E.2. infra.

²⁴ See, e.g., Form Letter B, Sykes Financial Letter, and Whitestone Letter, infra in Exhibit 1.

²⁵ See, e.g., Form Letter B, Curnes Financial Letter, and Marvel Financial Letter, infra in Exhibit 1.

²⁶ See Response Letter, supra note 5 at page 5.

comparing the absolute dollar value of the increase against the costs associated with operating FINRA's regulatory oversight programs and examination and enforcement responsibilities.²⁷

FINRA notes that over the past two years, a time marked by modest inflation, FINRA's annual funding mechanisms have proven insufficient to sustain its regulatory programs.²⁸ FINRA believes that, by assessing the fee increase from this perspective, the PA increase is reasonable and will better align FINRA's revenues with its costs. Based on projections that the registered representative population will modulate at a rate consistent with historical trends, FINRA estimates that the proposal will result in a total increase of \$42 million in PA fees, an average of approximately \$8,600 per firm. As noted above, FINRA further estimates that the average increase in total PA fees for firms with 100 or fewer registered persons – a population that constitutes 4,074 out of 4,868, or nearly 84%, of FINRA firms – will amount to approximately \$1,000 per firm, whereas the largest 100 firms (based on the number of registered persons as of year end 2008) will see an average increase of approximately \$300,000. FINRA notes that these estimates assume that firms do not pass along the PA to the individual registered persons, a practice that FINRA understands is done in certain segments of the securities industry. For firms that do engage in such practice, FINRA notes that the impact will shift from the firm to the registered persons.²⁹

Furthermore, FINRA believes that a PA fee of between \$130 and \$150 per year is reasonable, particularly when compared to other professional licensing fees.³⁰ According to FINRA, for the past two years, the PA has accounted for approximately 10-11% of FINRA's

²⁷ See Id. at page 5.

²⁸ See Id. at page 5.

²⁹ See Id. at page 6.

³⁰ See Id. at page 6.

regulatory revenue.³¹ With adoption of the proposed rule change, PA assessments will account for approximately 19% of FINRA's regulatory revenue.³² FINRA believes that this PA increase as a percentage of total regulatory revenue creates a more stable funding source with respect to FINRA's ability to mitigate any potentially negative fluctuations in GIA due to market conditions. FINRA believes that this is particularly important because regulatory demands typically rise in declining markets.³³

After reviewing the comment letters and considering FINRA's response to the commenters' issues, the Commission believes that the PA increase is reasonable. As FINRA notes, PA revenue is less vulnerable to economic fluctuations than the GIA. As a result, increasing the portion of regulatory revenue FINRA derives from the PA should reduce overall revenue volatility. In addition, the Commission believes that the dollar amount of the PA increase is reasonably correlated to FINRA's oversight of member firms and their registered representatives and will assist FINRA to comply with the statutory requirement that it have the capacity to be able to carry out the purposes of the Act and to enforce compliance by its members and persons associated with its members, with provisions of the Act, the rules and regulations thereunder, and FINRA's own rules.³⁴ Therefore, the Commission finds the increase in PA fees to be reasonable.³⁵

³¹ In 2008, PA accounted for \$44 million of \$454 million in total revenue or 9.7% and in 2009, PA accounted for \$44 million of \$383 million in total revenue or 11.5% See Response Letter, supra note 5 at page 4.

³² See Id. at page 4.

³³ See Id. at pages 4 and 6.

³⁴ See 15 U.S.C. 78o-3(b)(1)-(2).

³⁵ In addition, should large revenue surpluses occur in the future, FINRA notes that it will consider rebating those surpluses to members.

C. GIA Reformulation is Equitable

719 commenters argue that the burdens resulting from the reformulation of the GIA calculation will fall disproportionately on small firms and independent broker-dealers. Under the existing GIA rate structure, members are required to pay an annual GIA as follows:

- (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.

The proposed rule change will leave this seven-tiered structure unchanged but will assess GIA based on the greater of the amount that will be the current year GIA or a three-year average of the GIA to be calculated by adding the current year GIA plus the GIA assessed on the member over the previous two calendar years.³⁶ In its Response Letter, FINRA disagrees with the commenters that the revised GIA formulation will disadvantage small firms.³⁷ FINRA believes that the proposal instead aligns the fee revision with the largest 100 firms (based on the number of registered persons as of year-end of 2008 for PA and the amount of GIA assessed for 2008)³⁸ that primarily caused the GIA shortfall because of substantial write-downs against their FOCUS income. FINRA offers evidence, discussed in detailed below, in the form of data and projections

³⁶ For newer firms that have only been assessed in the prior year, FINRA will use a two-year average instead of a three-year average.

³⁷ See Response Letter, supra note 5 at page 6.

³⁸ See Id. at pages 6-7.

to demonstrate that the change to the GIA formulation will not unfairly burden small firms and independent broker-dealers but will largely fall on the largest 100 firms (based on the number of registered persons as of year-end of 2008 for PA and the amount of GIA assessed for 2008 for GIA) whose dramatic GIA decline in 2009 resulted in FINRA's need for additional fees.

FINRA notes that revenues from the GIA have dropped nearly \$100 million since 2008. Nearly \$95 million of that decline relates to the GIA paid in by the largest 100 GIA-assessed firms. Had the new proposed GIA calculation been in place for the 2009 billing cycle, FINRA projects that approximately \$47 million (nearly 49%) of the lost revenues would have been replaced, and these largest 100 GIA-assessed firms would have absorbed approximately \$44 million, or nearly 94%, of the shortfall. For 2010, FINRA estimates that with the proposed fee structure, the percentage of GIA paid will shift back toward the largest 100 GIA-assessed firms, rising to 63% from 57% in 2009. If the current GIA structure remains in place, these 100 firms are estimated to account for only 59% of GIA in 2010.³⁹

For firms with 100 or fewer registered persons, FINRA estimates that, if the proposal had been implemented for 2009, the new GIA calculation would have resulted in an average increased GIA of \$850 as compared to the actual amount assessed on those firms.⁴⁰ FINRA notes that these firms currently receive a rebate of \$1,200 against their GIA fee and that that rebate will continue until at least 2012. Therefore, under the current and the proposed GIA, these firms, if they have FOCUS revenues of less than \$1 million, effectively pay no GIA assessment.⁴¹

³⁹ See Id. at page 7.

⁴⁰ See Id. at page 7.

⁴¹ See Id. at page 7.

The Financial Services Institute (“FSI”), which represents the interests of independent broker-dealers, believes that the GIA modification is inequitably allocated and will “fall particularly heavily on independent broker-dealer firms....”⁴² FINRA believes that its data shows that the proposal, if implemented, will not disparately impact the GIA of independent firms.⁴³ FINRA reports that, for 2009, independent broker-dealers paid a total of \$11.63 million in GIA fees. Under the proposal, that figure is estimated to fall to \$11.17 million for 2010. By comparison, the GIA of the largest 100 GIA-assessed firms is projected to rise from \$94 million in 2009 to \$123.53 million under the proposal. Thus, FINRA believes that the increases resulting from the proposed GIA calculation will fall most heavily not on independent broker-dealers but on the largest 100 GIA-assessed firms, which include the several largest firms whose steep income declines primarily account for FINRA’s current revenue deficit.

After reviewing the comment letters and considering FINRA’s Response Letter, the Commission believes that the GIA reformulation is an equitable allocation of fees. As FINRA notes, nearly 95% of the \$100 million in GIA revenue drop since 2008 is attributable to the largest 100 GIA-assessed firms. Had the proposed new GIA calculation been in place for the 2009 billing cycle, FINRA projects that approximately \$47 million (nearly 49%) of the lost revenues would have been replaced, and those largest 100 GIA-assessed firms would have absorbed approximately \$44 million, or nearly 94%, of the shortfall. FINRA estimates also show that the new GIA calculation will increase the GIA burden for the largest 100 GIA-assessed firms in 2010 from 57% to 63% of total GIA revenue. The GIA assessments for the largest 100 GIA-assessed firms are predicted to be \$280,000 more per firm in 2010 under the new formulation than under the current formulation. The expected average increase for all other

⁴² See FSI Letter, infra in Exhibit 1.

⁴³ See Response Letter, supra note 5 at page at page 7.

firms is expected to be only \$1,000 per firm. The totality of the data appears to show that any increase that results from the new GIA formulation falls primarily on the largest 100 GIA-assessed firms, the same firms largely responsible for the revenue shortfall.

In addition, one commenter argues that using income to determine assessment fees is too simplified an approach and ignores many other factors that may be indicative of FINRA's regulatory costs relative to member firms, such as significant proprietary trading positions held by a member firm, holding of customer funds or securities by the member firm, and whether a member firm is self-clearing.⁴⁴ As FINRA notes, it has a large and diverse membership of differing sizes and business models and therefore it is impossible for FINRA to develop a pricing scheme that accounts for the particulars of every firm.⁴⁵ FINRA believes, and the Commission agrees, that the current pricing structure 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.⁴⁶ Therefore, the Commission finds that the proposed change to the GIA calculation will result in an equitable allocation that will help reduce the risk of future fluctuations in GIA income.

D. GIA Reformulation is Reasonable

Based on two quarters of 2009 FOCUS data, FINRA estimates that under the proposed GIA revision, in 2010, the assessment for the largest 100 firms (based on the amount of GIA assessed for 2008) will increase approximately \$280,00 per firm over the current formulation.⁴⁷ The remaining firms are estimated to experience an average increase of approximately \$1,000

⁴⁴ See MetLife Letter, infra in Exhibit 1.

⁴⁵ See Response Letter, supra note 5 at page 2.

⁴⁶ See Id. at page 2.

⁴⁷ See Id. at page 2.

per firm. FINRA believes that this increase does not disproportionately burden the firms outside of the largest 100 (based on the amount of GIA assessed for 2008) in terms of the revenue generated by those firms. In addition, FINRA contends that this increase is necessary to cover its costs of regulatory oversight and will ensure that it is able to continue meet its regulatory obligations.⁴⁸

One commenter, while appreciative of the need for stability resulting from the use of a three-year average, suggested that GIA should be based on a three-year average instead of the proposed greater of a three-year average or GIA based on actual current year FOCUS revenue.⁴⁹ The Commission notes that using the greater of the two figures allows FINRA to recoup any losses on a faster time frame, thereby reducing the duration of the risk that any deficits in funding would affect FINRA's ability to meet its statutory obligations. Therefore, the Commission finds that FINRA's proposed GIA reformulation is reasonable as proposed.

In addition, the Commission notes that the intent of the GIA reformulation is not to impose additional burdens on FINRA members. The intent is to enable FINRA to fulfill its regulatory obligations by guarding against future revenue declines as a result of drastic reductions in the FOCUS revenue of FINRA members. The introduction of a three-year average should make this revenue stream less volatile and more reliable for FINRA in the future. Therefore, the Commission believes that the proposed GIA increase is appropriate.

⁴⁸ See Response Letter, supra note 5 at page 6.

⁴⁹ See Committee of Annuity Issuers Letter, infra Exhibit 1.

E. Other Concerns of Commenters

1. FINRA Should Have Foreseen/Prepared for the Inevitable Shortfall

727 commenters state that FINRA should have predicted the market downturn and taken budgetary steps to account for it. As many commenters stated in Letter Type B, “FINRA’s failure to properly prepare for the inevitable market downturn is the root cause of their operating cash flow concerns.”⁵⁰

The Commission notes that FINRA is an SRO and is obligated under the Act to carry out its regulatory obligations even during a period of economic downturn. FINRA notes that it actually planned for a decline in GIA from 2008 to 2009 and accordingly adjusted its 2009 budget downward compared to 2008 in anticipation of the reduced revenues.⁵¹ The Commission is aware that, in a market downturn, each element of FINRA’s funding sources is vulnerable. A firm’s gross income declines as its trading activity declines, thereby affecting FINRA’s funding for its regulatory programs. It would be difficult for FINRA to account for economic events outside of its control when planning its regulatory program needs and its budget. This is because one of FINRA’s primary means of meeting its regulatory costs is the GIA, and the funding FINRA receives from the GIA is wholly dependent on firms’ revenues.⁵² Moreover, to the extent that the commenters raise issues with FINRA’s balance sheet investments, the Commission agrees with FINRA that those comments are misplaced. The balance sheet is used to augment FINRA’s funding and thereby decrease the full cost of regulation assessed to FINRA’s member firms; its value does not negate the need to adequately fund FINRA’s

⁵⁰ See Letter Type B.

⁵¹ See Response Letter, supra note 5 at page 4-5.

⁵² See Id. at page 4.

regulatory programs. As an SRO, FINRA's needs and requirements differ from those of its members and it would be improper for FINRA to cut its regulatory programs to adjust to leaner times when those programs are necessary to meet its statutory obligations. As FINRA has noted, it has established a comprehensive cost-cutting program that so far has reduced expenses that do not directly impact its regulatory programs by more than \$70 million from the prior year.⁵³ This cost-cutting is in addition to the income yield from its balance sheet portfolio that supplements the PA and GIA fees. In the Commission's view, FINRA's fee proposal is fair and reasonable in light of FINRA's regulatory responsibilities.

2. Any Fee Increase is Inappropriate Given the Current Economic Conditions

728 commenters believe that the proposal is unfair because it occurs at a time when firms are suffering financially and have incurred fee increases from a variety of other entities, including the Commission, the Securities Investor Protection Corporation, a national securities exchange, the Municipal Securities Rulemaking Board and several states. In response, FINRA notes that its regulatory responsibilities have not lessened – if anything, they may have increased.

⁵⁴ To that end, FINRA refers to statistics that demonstrate that the population of registered representatives has remained fairly constant, even throughout recent market events.⁵⁵ The Commission strongly believes that FINRA must have sufficient resources to carry out its statutory obligations, particularly during periods of market turmoil, even when its members also are assessed fees by other organizations or governmental entities. In the Commission's view, fee increases imposed by other regulators, market operators or securities-related entities are not dispositive regarding whether it is appropriate for FINRA to increase its regulatory fees. The

⁵³ See Id. at page 2.

⁵⁴ See Id. at page 5.

⁵⁵ See supra, note 6.

proposed PA and GIA fee increases are designed to allow FINRA to maintain a robust regulatory program, which the Commission believes is both necessary and appropriate so that FINRA can carry out its regulatory responsibilities effectively.

F. Other Approaches Suggested by Commenters

In addition to the concerns and suggestions raised by commenters that are discussed above, commenters offered several alternative approaches to the proposed PA and GIA increases. For example, some commenters suggest that the proposed revisions to PA and GIA assessments be capped at a certain amount or phased in over a period of years.⁵⁶ Other commenters note that FINRA has failed to sufficiently demonstrate a need for additional revenue in the form of increased PA and GIA.⁵⁷

1. Caps on Increases or Phase-In Period

Eight commenters suggest that any fee increase should be subject to an annual cap or a gradual phase-in period.⁵⁸ One commenter suggests a one year delay in any fee increase⁵⁹ while another commenter favors a three year phase-in period for any fee increase.⁶⁰ Three other commenters recommend a phase-in period of an unspecified length.⁶¹ Five of the commenters

⁵⁶ See e.g., SIFMA Letter, MetLife Letter, and GBS Financial Letter, infra Exhibit 1.

⁵⁷ See e.g., Whitestone Letter, PFS Investment Letter, and SagePoint Financial Letter, infra Exhibit 1.

⁵⁸ See Foresters Equity Letter, State Farm Letter, FSI Letter, MetLife Letter, GBS Financial Letter, SIFMA Letter, World Group Letter, and Committee of Annuity Insurers Letter, infra Exhibit 1.

⁵⁹ See Foresters Equity Letter, infra Exhibit 1.

⁶⁰ See FSI Letter, infra Exhibit 1.

⁶¹ See GBS Financial Letter, SIFMA Letter, and World Group Letter, infra Exhibit 1.

avored a cap on any PA increase. Two of these commenters support a 10% cap,⁶² another commenter prefers a 10%-15% cap,⁶³ and the two others do not suggest a specific amount.⁶⁴

In its Response Letter, FINRA states that it is critical to implement the proposed rule change as of January 2010 and without any limitations. FINRA notes that it has already phased in the need for additional assessed funding by not charging firms in 2008 and 2009 for cash flow shortfalls that are funded out of its capital. FINRA points out that the GIA will remain subject to an existing cap for 2010,⁶⁵ but notes that any further caps could leave FINRA facing the same fiscal quandary it currently faces in the event of continuing decreased revenue at firms. For the same reason, FINRA opposes a phased-in implementation period. FINRA believes that prolonging implementation of these changes will only lead to a “geometric future fee increase, as FINRA perpetuates a budget imbalance and depletes its revenue-producing assets.”⁶⁶

The Commission agrees with FINRA that by not charging members increases in 2008 and 2009 when its cash flow shortfalls were occurring, FINRA effectively has provided a type of delayed or phased-in implementation of the fee increases. The Commission also agrees with FINRA’s view that any further delay in implementing the fee increases could result in a greater financial impact to firms in the future and, in the Commission’s view, could potentially impact FINRA’s ability to meet its statutory requirements. Therefore, the Commission believes that it is

⁶² See State Farm Letter and Committee of Annuity Insurers Letter, infra Exhibit 1.

⁶³ See Foresters Equity Letter, infra Exhibit 1.

⁶⁴ See SIFMA Letter and World Group Letter, infra Exhibit 1.

⁶⁵ For 2010, any increase or decrease in GIA will be capped at 10% of what a firm would have paid under the prior NASD or NYSE rate structures that it was subject to before FINRA’s GIA rate structure was amended in 2008.

⁶⁶ See Response Letter, supra note 5 at page 8.

reasonable for FINRA to refrain from implementing a yearly cap on, or a phase-in period for, the PA and GIA fee increases.

2. FINRA Does Not Need the Additional Revenue

Nine commenters suggest that FINRA has failed to sufficiently demonstrate a need for additional revenue and thus argue against any increase in the PA or GIA.⁶⁷ One commenter remarks that “it is apparent from FINRA’s annual report that the organization has more than adequate assets and reserves to withstand the recent downturn.”⁶⁸ Another commenter states that “FINRA's proposed Rule Change lacks proper and adequate support. Nowhere does FINRA provide any disclosure of what proportion PA and GIA fees represent in its revenue or income. Nor does FINRA describe its financial or investment models or state what if any preparations or actions it took or has taken in light of the economic and industry downturns.”⁶⁹

In its Response Letter, FINRA states that income from its reserves is used to offset a part of the cost of its regulatory program each year, and consequently that funding stream is in lieu of a more substantial fee increase on members.⁷⁰ FINRA expects such income to offset regulatory costs by approximately \$50 million in 2010.⁷¹ Moreover, FINRA notes that it delayed seeking any fee increase for 2008 and 2009 by utilizing the principal of its reserves. However, FINRA does not believe that it would be prudent to continue to exhaust its reserves to cover all future

⁶⁷ See IBN Financial Letter, First Independent Letter, Whitestone Letter, JanHobbs Financial Letter, SagePoint Financial Letter, Magdaleno Letter, GBS Financial Letter, FSC Securities Letter, and PFS Investment Letter, infra Exhibit 1.

⁶⁸ See e.g., First Independent Letter, infra Exhibit 1.

⁶⁹ See e.g., FSC Securities Letter, infra Exhibit 1.

⁷⁰ See Response Letter, supra note 5 at page 3.

⁷¹ See Id. at page 3.

operating deficits, because such a practice is unsustainable and would inevitably result in a much more substantial fee increase in the future.⁷²

FINRA further notes that it has minimized the proposed fee increases through a comprehensive cost-cutting program that so far has reduced expenses that do not directly impact its regulatory programs by more than \$70 million from the prior year.⁷³ According to FINRA, it supplements, where possible, member fees and assessments with the income yield from its balance sheet portfolio. FINRA states that by reallocating assets it has reduced performance volatility, while creating a more reliable income stream to subsidize fees. However, FINRA notes that these actions alone have been insufficient to make up the funding deficits it has experienced over the prior two years. According to FINRA, the proposed rule change is intended to remedy ongoing deficits and ameliorate vulnerability to future revenue shortfalls. Therefore, FINRA believes that the proposed fee increases are necessary and any delay in their implementation will necessitate future fee increases of much greater magnitude.⁷⁴

The Commission believes that FINRA has sufficiently demonstrated that the proposed increases in PA and GIA fees are necessary to adequately support FINRA's regulatory programs. FINRA makes a compelling argument that its balance sheet resources are finite and cannot be relied upon solely to overcome a regulatory revenue shortfall. As an SRO, FINRA needs to maintain adequate reserves to ensure that it can continue to operate a vigorous regulatory system. In addition, the Commission notes that FINRA has implemented cost cutting measures and taken other steps to minimize the magnitude of the proposed fee increases. Therefore, the Commission finds that the proposed fee increases are equitable and consistent with the Act.

⁷² See Id. at pages 3-4.

⁷³ See Id. at page 2.

⁷⁴ See Id. at page 2.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁷⁵ that the proposed rule change (SR-FINRA-2009-057), be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁷⁶

Florence E. Harmon
Deputy Secretary

⁷⁵ 15 U.S.C. 78s(b)(2).

⁷⁶ 17 CFR 200.30-3(a)(12).

EXHIBIT 1

Comments on FINRA Rulemaking

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to Section 1(c) of Schedule A to the FINRA By-Laws to Amend the Personnel Assessment and Gross Income Assessment

(Release No. 34-60624; File No. SR-FINRA-2009-057)

Total Number of Comment Letters Received - 745

Comments have been received from individuals and entities using the following Letter Types:

- a. 4 individuals or entities using Letter Type A
- b. 672 individuals or entities using Letter Type B

1. Jonathan Zulauf, dated September 2, 2009
2. Richard J. Carlesco Jr., LUTCF, IBN Financial Services, Inc., dated September 17, 2009 (“IBN Financial Letter”)
3. Phillip H. Palmer, ChFC, President and CEO, First Independent Financial Services Inc. dated September 17, 2009 (“First Independent Letter”)
4. William R. Sykes, President, Sykes Financial Services LLC, dated September 17, 2009 (“Sykes Financial Letter”)
5. Anthony Pappas, Ph.D., President, Whitestone Securities Inc., dated September 21, 2009 (“Whitestone Letter”)
6. David M. Sobel, Esq., EVP/COO, Abel/Noser Corp., dated September 22, 2009 (“Abel Noser Letter”)
7. Kevin Hart Korfield, Kevin Hart Korfield & Co. Inc. dated September 23, 2009
8. Nancy Wheeler Bertacini, Curnes Financial Group, FNIC, dated September 24, 2009 (“Curnes Financial Letter”)
9. David L. Ehrig, dated September 24, 2009
10. Janice Hobbs, President, JanHobbs Financial Group, dated September 24, 2009 (“JanHobbs Financial Letter”)
11. Bryon Holz, dated September 24, 2009

12. John Ikeda, Registered Principal Financial Network Investment Corp., dated September 24, 2009 (“Financial Network Letter”)
13. Timothy Jones, Chairman CJM Wealth Advisers LTD, dated September 24, 2009
14. Kate Marvel, President, Marvel Financial Planning, Inc., dated Spetember 24, 2009 (“Marvel Financial Letter”)
15. Jonathan Meany, CFP, dated September 24, 2009
16. Gary Orlor, Investment Executive, Raymond James Financial Services, Inc., dated September 24, 2009
17. Suzanne Seay, CFP, Royal Alliance, dated September 24, 2009
18. John Sklencar, Financial Advisor FSC Securities Corp., dated September 24, 2009
19. Frank L. Smith, President, Foresters Equity Services, Inc., dated September 24, 2009 (“Foresters Equity Letter”)
20. Daniel G. Trout, Senior Associate, Financial Principles LLC, dated September 24, 2009
21. James Woytcke, CEO/Owner, Financial Success Ltd., dated September 24, 2009
22. Tim, dated September 24, 2009
23. Jeffrey M. Auld, President and Chief Executive Officer, SagePoint Financial Inc., dated September 24, 2009 (“SagePoint Letter”)
24. Kurt Dressler, Capital Investment Counsel, dated September 25, 2009
25. Bruce Ferguson, Managing Member, Raymond James Financial, dated September 25, 2009
26. Pamela Fritz, CCO, MWA Financial Services, dated September 25, 2009
27. Robert B. Lyons, CLU, ChFC, ING Financial Partners, dated September 25, 2009
28. Brian Perley, ChFC, CFP, Hammond Financial Inc., dated September 25, 2009
29. S. Ann Pugh, CFP, ING Financial Partners, dated September 25, 2009
30. William Robbins, Registered Representative, Coordinated Capital Securities, Inc., dated September 25, 2009

31. Stephen Russell, Senior Vice President, VSR Financial Services, dated September 25, 2009
32. James G. Timpa, dated September 25, 2009
33. Sherri White, CPA/PFS, dated September 25, 2009
34. Martin Cohen, President, Balanced Financial Securities, dated September 26, 2009
35. Joel Dash, dated September 28, 2009
36. D.W. Hadley, Jr., Capital Analyst of NC inc., dated Spetember 28, 2009
37. Michelle E. Heyne, CCO, McAdams Wright Ragen, Inc., dated September 28, 2009
38. Penn Rettig, Branch Manager, Multi Financial Securities Corp., dated September 28, 2009
39. Donna M. Stevenson, dated September 28, 2009
40. John Terry, President, High Street Securities Inc., dated September 28, 2009
41. Russell L. Bacon, MBA, CSA, Director, Montgomery Wealth Management, dated September 29, 2009
42. Robert Black, Jr., President, Legacy Planning Group, dated September 29, 2009
43. Nicholas C. Cochran, Vice President, American Investors Company, dated September 29, 2009
44. Pamela Goodall, dated September 29, 2009
45. Cynthia Iquinto, Registered Representative, FSC Securities Corporation, dated September 29, 2009
46. Jim Loessberg, Financial Advisor, Raymond James Financial, dated September 29, 2009
47. Sandra Hay Magdaleno, CFP, dated September 29, 2009 (“Magdaleno Letter”)
48. Edward Skelly, President, Sterling Financial Planners, dated September 29, 2009
49. Neal E. Nakagiri, President, CEO, CCO, NPB Financial Group LLC, dated September 30, 2009
50. Kevin Tucker, dated September 30, 2009

51. Paige W. Pierce, CEO, RW Smith Associates Inc., dated October 1, 2009
52. Richard P. Woltman, CEO & Chairman, Girard Securities Inc., dated October 1, 2009
53. David E. Axtell, Compliance Director, State Farm Investment Management Corp, dated October 2, 2009 (“State Farm Letter”)
54. Dale E. Brown, CAE, President & CEO, Financial Services Institute, Inc., dated October 2, 2009
55. Paul Cellupica, Chief Counsel, Securities Regulation & Corporate Services, MetLife, Inc., dated October 2, 2009 (“MetLife Letter”)
56. James M. Clous, Registered Representative, dated October 2, 2009
57. Gerard P. Gloisten, President, GBS Financial Corp, dated October 2, 2009 (“GBS Financial Letter”)
58. Ronald C. Long, Director, Regulatory Affairs, Wells Fargo Advisors, dated October 2, 2009
59. Debra G. McGuire, CPA, McGuire Dyke Investment Group, dated October 2, 2009
60. E. John Moloney, Chairman, SIFMA Small Firms Committee, Securities Industry and Financial Markets Association, dated October 2, 2009 (“SIFMA Letter”)
61. Kevin L. Palmer, CEO/President, World Group Securities Inc., dated October 2, 2009 (“World Group Letter”)
62. Mark J. Schlafly, President & CEO, FSC Securities Corporation, dated October 2, 2009 (“FSC Securities Letter”)
63. Sutherland Asbill & Brennan LLP, on behalf of Committee of Annuity Insurers, dated October 2, 2009 (“Committee of Annuity Insurers Letter”)
64. John S. Watts, SVP & Chief Counsel, PFS Investment Inc., dated October 2, 2009 (“PFS Investment Letter”)
65. Edward Wiles, SVP & CCO, Genworth Financial Securities Corp, dated October 2, 2009
66. Cuneo, Gilbert & Laduca LLP and Greenfield & Goodman LLC, on behalf of Standard Investment Chartered Inc., dated October 5, 2009
67. Elliott Harris, dated October 5, 2009

68. Daniel W. Roberts, President/CEO, Roberts & Ryan Investments Inc., dated October 5, 2009
69. Mark E. Larson, Esquire, CPA, Academic Director of the Certificate in Financial planning Program at Marquette University, dated October 13, 2009