

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72208; File No. SR-FINRA-2014-023)

May 21, 2014

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Adopt FINRA Rule 2121 (Fair Prices and Commissions), Supplementary Material .01 (Mark-Up Policy) and Supplementary Material .02 (Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities) 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 May 9, 2014, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by FINRA. FINRA has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,³ which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

FINRA is proposing to adopt current NASD Rule 2440 and Interpretive Material (“IM”) 2440-1 and IM-2440-2 as FINRA Rule 2121 (Fair Prices and Commissions), Supplementary Material .01 (Mark-Up Policy) and Supplementary Material .02 (Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

Securities) without any substantive changes. FINRA also proposes to update references and cross-references within Supplementary Material .01 and .02, and in other FINRA rules accordingly.⁴

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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**Text of Proposed New FINRA Rules
(Marked to Show Changes from NASD Rule 2440, IM-2440-1 and IM-2440-2;
NASD Rule 2440, IM-2440-1 and IM-2440-2 to be Deleted in their Entirety)**

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2000. DUTIES AND CONFLICTS

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2100. TRANSACTIONS WITH CUSTOMERS

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2120. Commissions, Mark Ups and Charges

[2440.] 2121. Fair Prices and Commissions

No Change.

••• Supplementary Material: -----

[IM-2440-1.] .01 Mark-Up Policy

The question of fair mark-ups or spreads is one which has been raised from the earliest days of the National Association of Securities Dealers (“Association”). No

⁴ The text of FINRA Rule 3170, which contains a cross-reference to NASD Rule 2440 that will be updated as part of this proposal, was approved by the SEC on December 23, 2013. (See Securities Exchange Act Release No. 71179 (December 23, 2013); 78 FR 79542 (December 30, 2013) (Order Approving SR-FINRA-2013-025)). The effective date for this rule is December 1, 2014.

definitive answer can be given and no interpretation can be all-inclusive for the obvious reason that what might be considered fair in one transaction could be unfair in another transaction because of different circumstances. In 1943, the Association’s Board adopted what has become known as the “5% Policy” to be applied to transactions executed for customers. It was based upon studies demonstrating that the large majority of customer transactions were effected at a mark-up of 5% or less. The Policy has been reviewed by the Board of Governors on numerous occasions and each time the Board has reaffirmed the philosophy expressed in 1943. Pursuant thereto, and in accordance with Article VII, Section 1(a)(ii) of the By-Laws, the Board [has] adopted the following interpretation_ [under Rule 2440.]

It shall be deemed a violation of Rule [2110] 2010 and Rule [2440] 2121 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission which is not reasonable.

(a) through (d) No Change.

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[IM-2440-2.] .02 Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities¹

(a) Scope

[(1) IM-2440-1] Supplementary Material .01 to Rule 2121 applies to debt securities transactions, and this [IM-2440-2] Supplementary Material .02 supplements the guidance provided in [IM-2440-1] Supplementary Material .01.

(b) Prevailing Market Price

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. Presumptively for purposes of this [IM-2440-2] Supplementary Material .02, the prevailing market price for a debt security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with [NASD] FINRA pricing rules. (See, e.g., Rule [2320] 5310).

(2) through (6) No Change.

(7) Finally, if information concerning the prevailing market price of the subject security cannot be obtained by applying any of the above factors, [NASD] FINRA or its members may consider as a factor in assessing the prevailing market price of a debt security the prices or yields derived from economic models (e.g., discounted cash flow models) that take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (e.g., coupon frequency and accrual methods). Such models currently may be in use by bond dealers or may be specifically developed by regulators for surveillance purposes.

(8) No Change.

(9) "Customer," for purposes of Rule [2440] 2121, [IM-2440-1] Supplementary Material .01 to Rule 2121 and this [IM-2440-2] Supplementary Material .02, shall not include a qualified institutional buyer ("QIB") as defined in Rule 144A under the Securities Act of 1933 that is purchasing or selling a non-

investment grade debt security when the dealer has determined, after considering the factors set forth in [IM-2310-3] Rule 2111(b), that the QIB has the capacity to evaluate independently the investment risk and in fact is exercising independent judgment in deciding to enter into the transaction. For purposes of Rule [2440] 2121, [IM-2440-1] Supplementary Material .01 to Rule 2121 and this [IM-2440-2] Supplementary Material .02, “non-investment grade debt security” means a debt security that: (i) if rated by only one nationally recognized statistical rating organization (“NRSRO”), is rated lower than one of the four highest generic rating categories; (ii) if rated by more than one NRSRO, is rated lower than one of the four highest generic rating categories by any of the NRSROs; or (iii) if unrated, either was analyzed as a non-investment grade debt security by the dealer and the dealer retains credit evaluation documentation and demonstrates to [NASD] FINRA (using credit evaluation or other demonstrable criteria) that the credit quality of the security is, in fact, equivalent to a non-investment grade debt security, or was initially offered and sold and continues to be offered and sold pursuant to an exemption from registration under the Securities Act of 1933.

(c) “Similar” Securities

(1) No Change.

(2) The degree to which a security is “similar,” as that term is used in this [IM-2440-2] Supplementary Material .02, to the subject security may be determined by factors that include but are not limited to the following:

(A) through (D) No Change.

(3) No Change.

¹ No Change.

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3000. SUPERVISION AND RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS

3100. SUPERVISORY RESPONSIBILITIES

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3170. Tape Recording of Registered Persons by Certain Firms

(a) Definitions

(1) through (2) No Change.

(3) For purposes of this Rule, the term “disciplinary history” means a finding of a violation by a registered person in the past five years by the SEC, a self-regulatory organization, or a foreign financial regulatory authority of one or more of the following provisions (or comparable foreign provision) or rules or regulations thereunder: violations of the types enumerated in Exchange Act Section 15(b)(4)(E); Exchange Act Section 15(c); Securities Act Section 17(a); SEA Rules 10b-5 and 15g-1 through 15g-9; NASD Rule 2110 (Standards of Commercial Honor and Principles of Trade) or FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) (only if the finding of a violation of NASD Rule 2110 or FINRA Rule 2010 is for unauthorized trading, churning, conversion, material misrepresentations or omissions to a customer, frontrunning, trading ahead of research reports or excessive markups), FINRA Rule 5280 (Trading Ahead of Research Reports), NASD Rule 2120 (Use of Manipulative,

Deceptive or Other Fraudulent Devices) or FINRA Rule 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices), NASD Rule 2310 (Recommendations to Customers (Suitability)) or FINRA Rule 2111 (Suitability), NASD Rule 2330 (Customers' Securities or Funds) or FINRA Rule 2150 (Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts), NASD Rule 2440 or FINRA Rule 2121 (Fair Prices and Commissions), NASD Rule 3010 (Supervision) or FINRA Rule 3110 (Supervision) (failure to supervise only for both NASD Rule 3010 and FINRA Rule 3110), NASD Rule 3310 (Publication of Transactions and Quotations) or FINRA Rule 5210 (Publication of Transactions and Quotations), and NASD Rule 3330 (Payment Designed to Influence Market Prices, Other than Paid Advertising) or FINRA Rule 5230 (Payments Involving Publications that Influence the Market Price of a Security); and MSRB Rules G-19, G-30, and G-37(b) & (c).

(4) through (5) No Change.

(b) through (d) No Change.

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5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

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5300. HANDLING OF CUSTOMER ORDERS

5310. Best Execution and Interpositioning

(a) through (d) No Change.

(e) The obligations described in paragraphs (a) through (d) above exist not only where the member acts as agent for the account of its customer but also where transactions are executed as principal. Such obligations are distinct from the reasonableness of commission rates, markups or markdowns, which are governed by [NASD Rule 2440 and IM-2440] Rule 2121 and its Supplementary Material.

••• Supplementary Material: -----

.01 through .09 No Change.

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6000. QUOTATION AND TRANSACTION REPORTING FACILITIES

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6600. OTC REPORTING FACILITY

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6630. Applicability of FINRA Rules to Securities Previously Designated as PORTAL Securities

(a) The following are specifically applicable to transactions and business activities relating to securities that, prior to October 26, 2009, had been designated by The Nasdaq Stock Market LLC for inclusion in the PORTAL Market (“PORTAL securities”):

(1) [NASD Rule 2440, and] FINRA Rules 0130, 0140, 2010, 2020, 2111, 2121, 2232, 2251, 2261, 2262, 2269, 5310, 8210;

(2) No Change.

(3) FINRA Rules 5210, 5220, Supplementary Material to Rule 2121, and NASD IM-2420-1[, IM-2440-1, and IM-2440-2].

(b) through (d) No Change.

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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"),⁵ FINRA is proposing to transfer NASD Rule 2440 (Fair Prices and Commissions) into the Consolidated FINRA Rulebook as FINRA Rule 2121.

NASD Rule 2440 provides that for securities transactions in both listed and unlisted securities a member that buys for his own account from his customer, or sells for his own account to his customer, shall buy or sell at a price that is fair taking into consideration all relevant circumstances, including market conditions with respect to such security at the

⁵ 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).

time of the transaction, the expense involved, and the fact that it is entitled to a profit.⁶ Further, if the member acts as agent for its customer in any such transaction, that member shall not charge its customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order, and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market therefor.⁷ FINRA proposes to transfer this rule into the Consolidated FINRA Rulebook without any substantive changes.⁸

With NASD Rule 2440, FINRA also is proposing to transfer IM-2440-1 (Mark-Up Policy) and IM-2440-2 (Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities) as Supplementary Material .01 and .02, respectively. IM-2440-1 provides additional guidance as to what may constitute a fair price or spread; IM-2440-2 provides additional guidance for mark-ups related to transactions in debt securities, except municipal securities. As with NASD Rule 2440,

⁶ NASD Rule 2440.

⁷ NASD Rule 2440.

⁸ FINRA previously has solicited comment on a proposal to move NASD Rule 2440 to the FINRA rules with substantive changes. See Regulatory Notice 11-08 (February 2011); see also Regulatory Notice 13-07 (January 2013). Given that these proposals raised complex issues and FINRA would like to proceed with the rulebook consolidation process expeditiously, FINRA is proposing in this rule change to move Rule 2440 and its Interpretive Materials to the FINRA rules without substantive changes, and will defer proposing any substantive changes to the rule to a future rule proposal.

FINRA proposes to transfer these Interpretive Materials without any substantive changes.⁹

FINRA also is proposing to update references and cross-references within Supplementary Material .01. Specifically, FINRA is clarifying that the reference to “Association” in this Supplementary Material is to the National Association of Securities Dealers. FINRA is updating the reference in this Supplementary Material to NASD Rule 2110, which is now FINRA Rule 2010. FINRA is also updating Supplementary Material .02 to change references to NASD to FINRA, to update the reference to NASD Rule 2320 to FINRA Rule 5310, and to update the reference to NASD IM-2310-3 to FINRA Rule 2111(b).

FINRA also proposes to update other FINRA rules as necessary to reflect the transfer of NASD Rule 2440 and its Interpretive Material to FINRA Rule 2121 and its Supplementary Material.

FINRA has filed the proposed rule change for immediate effectiveness.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁰ 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

⁹ In addition to transferring IM-2440-1 to Supplementary Material .01, FINRA is changing the introductory language in IM-2440-1, which describes the adoption of the interpretation set forth in that provision, to reflect the historical nature of that adoption.

¹⁰ 15 U.S.C. 78o-3(b)(6).

interest. FINRA believes that this proposed rule change, which does not substantively change the rule, is consistent with the Act because it is being undertaken pursuant to the rulebook consolidation process, which is designed to provide additional clarity and regulatory efficiency to FINRA members by consolidating the applicable NASD, Incorporated NYSE, and FINRA rules into one rule set.

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. As noted above, this proposal will not substantively change either the text or the application of the rule and its supporting material.

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 with respect to this proposal to transfer NASD Rule 2440 and its supporting Interpretive Material into the Consolidated FINRA Rulebook without any substantive changes.¹¹

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹² and Rule 19b-4(f)(6) thereunder.¹³

¹¹ But see note 8 supra.

¹² 15 U.S.C. 78s(b)(3)(A).

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

IV. Solicitation of Comments

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2014-023 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2014-023. This file number should be included on the subject line if e-mail is used. To help the Commission process

¹³ 17 CFR 240.19b-4(f)(6). As required under Rule 19b-4(f)(6)(iii), FINRA provided the Commission with written notice of its intention to file the proposed rule change at least five business days prior to filing the proposal with the Commission or such shorter period as designated by the Commission.

and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 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-2014-023 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.¹⁴

Kevin M. O'Neill
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).