ATTACHMENT A to *Regulatory Notice 11-08*

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

* * * * *

Text of Proposed New FINRA Rules
(Marked to Show Changes from NASD Rules 2440 and 2430, and NASD IM-2440-1 and IM-2440-2; NASD Rules 2440 and 2430, and NASD IM-2440-1 and IM-2440-2 to be Deleted in Their Entirety from the Transitional Rulebook)

* * * * *

2000. DUTIES AND CONFLICTS

* * * * *

2100. TRANSACTIONS WITH CUSTOMERS

* * * * *

2120. Markups, Commissions and Fees

[2440]2121. Fair Prices and Markups, Markdowns and Commissions

(a) Fair and Reasonable Markups, Markdowns and Commissions

In any securities transaction[s], [whether in "listed" or "unlisted" securities,] if a member acts as principal and buys for the member's [his own] account from [his] its customer, or sells from the member's [for his own] account to [his] its customer, [he] the member shall buy or sell at a price which is fair and reasonable, taking into consideration all relevant facts and circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that the member[he] is entitled to remuneration. [a profit; and i]If a member [he] acts as agent for the member's [his] customer in any [such] securities transaction, the member [he] shall not charge its [his] customer more than a fair and reasonable commission, commission-equivalent fee, or service charge, taking into consideration all relevant facts and 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] the member may have rendered by reason of its [his] experience in and knowledge of such security and the market for the security [therefor].

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

[The question of fair mark-ups or spreads is one which has been raised from the earliest days of the Association. No 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 and Rule 2440 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.]

(b[a]) General Considerations

[Since the adoption of the "5% Policy" the Board has determined that:]

[(1) The "5% Policy" is a guide, not a rule.]

(1[2]) A member may consider its expenses, but shall not justify mark[-]ups, markdowns, or commissions on the basis of expenses [which] that are excessive.

(2[3]) The difference between the customer's price (including the mark[-]up or markdown) [over] and the prevailing market price is the amount (or percentage) to be considered when determining if a member deals fairly [significant spread from the point of view of fairness of dealings] with its customer[s] in a principal transaction[s]. [In the absence of other bona fide evidence of the prevailing market,]For a markup, a member's own contemporaneous cost is the best indication of the prevailing market price of a security, and for a markdown, a member's own contemporaneous proceeds are the best indication of the prevailing market price of a security, unless other bona fide, more credible evidence of the prevailing market price can be evidenced.

(3) If a member sells a security to a customer from inventory or buys a security from a customer for inventory, the amount of profit or loss to the member from market appreciation or depreciation before, or after, the date of the transaction with the customer would not ordinarily enter into the determination of the amount or fairness of the markup or markdown.

[(4) A mark-up pattern of 5% or even less may be considered unfair or unreasonable under the "5% Policy."]

(4[5]) Determination of the fairness of a mark[-]up[s], markdown or commission must be based on a consideration of all the relevant factors, of which the percentage of mark[-]up, markdown or commission is only one.

(c[b]) Relevant Factors

[Some of the factors which the Board believes that members and the Association's committees should take into consideration in determining the fairness of a mark-up are as follows:]Factors that a member should take into consideration in determining if a markup, markdown or commission is fair and reasonable include, but are not limited to, the following:

(1) The Type of Security Involved

Some securities customarily carry a higher mark[-]up, markdown or commission than others. For example, a higher percentage of mark[-]up customarily applies to a common stock transaction than to a bond transaction of the same size. [Likewise, a]A higher percentage markup, markdown or commission customarily applies to sales of units of direct participation programs and condominium securities than to sales of common stock.

(2) The Availability of the Security in the Market

In the case of an inactive security the effort and cost of buying or selling the security, or any other unusual circumstances connected with its acquisition or sale, may [have a bearing on] be a factor in determining the amount (or percentage) of mark[-]up, markdown or commission [justified].

(3) The Price of the Security

While there is no direct correlation, the percentage of mark[-]up, markdown or [rate of] commission generally increases as the price of the security decreases. Even where the amount of money is substantial, transactions in lower priced securities may require more handling and expense and may warrant a larger markup, markdown or commission [wider spread].

(4) The Amount of Money Involved in a Transaction

A transaction that [which] involves a small amount of money may warrant a higher percentage of mark[-]up, markdown or commission to cover the expenses of handling.

(5) Disclosure

[Any disclosure to the customer, before the transaction is effected, of] Where a member discloses [information which would indicate] the amount of (A) [the amount of] the commission charged in an agency transaction or (B) the mark[-]up or markdown made in a principal transaction to a customer before the transaction is effected, such disclosure may be considered in determining if a member deals fairly with a customer [is a factor to be considered]. Disclosure itself, however, does not justify a markup, markdown or commission [or mark-up which] that is unfair or excessive in light of all other relevant facts and circumstances surrounding the transaction.

(6) The Pattern of Mark[-U]ups

[While]Although the markup, markdown or commission in each transaction must be fair and reasonable, [meet the test of fairness, the Board believes that] particular attention should be given to [the] a member's pattern of [a member's] mark[-]ups, markdowns and commissions.

(7) The Nature of the Member's Business

[The Board is aware of the differences in t]The services and facilities [which] that customers desire or need [are needed by,] and members provide[d] differ [for,] among members and allow customers to choose among levels and types of services and facilities [customers of members]. If not excessive, the cost of providing such services and facilities, particularly when they are of a

continuing nature, may properly be considered in determining the fairness of a member's mark[-]ups, markdowns, and commissions.

[(c) Transactions to Which the Policy is Applicable]

[The Policy applies to all securities, whether oil royalties or any other security, in the following types of transactions:]

[(1) A transaction in which a member buys a security to fill an order for the same security previously received from a customer. This transaction would include the so-called “riskless” or “simultaneous” transaction.]

[(2) A transaction in which the member sells a security to a customer from inventory. In such a case the amount of the mark-up would be determined on the basis of the mark-up over the bona fide representative current market. The amount of profit or loss to the member from market appreciation or depreciation before, or after, the date of the transaction with the customer would not ordinarily enter into the determination of the amount or fairness of the mark-up.]

[(3) A transaction in which a member purchases a security from a customer. The price paid to the customer or the mark-down applied by the member must be reasonably related to the prevailing market price of the security.]

[(4) A transaction in which the member acts as agent. In such a case, the commission charged the customer must be fair in light of all relevant circumstances.]

[(5) Transactions wherein a customer sells securities to, or through, a broker/dealer, the proceeds from which are utilized to pay for other securities purchased from, or through, the broker/dealer at or about the same time. In such instances, the mark-up shall be computed in the same way as if the customer

had purchased for cash and in computing the mark-up there shall be included any profit or commission realized by the dealer on the securities being liquidated, the proceeds of which are used to pay for securities being purchased.]

(d) Transactions to Which the Rule [Policy] is Not Applicable

This Rule does not apply [The Mark-Up Policy is not applicable]to (1) the sale of securities where a prospectus or offering circular is required to be delivered and the securities are sold at the specific public offering price;[.] or (2) a transaction with a qualified institutional buyer ("QIB") that meets the conditions of Rule 2122(b)(9).

(e) Commission Schedules

(1) A member shall establish and make available to retail customers a schedule(s) of commission charges for transactions with retail customers in equity securities, which shall reflect the standard commission or range of commissions that the member charges for such transactions. If a member makes available more than one schedule, the member shall disclose the manner in which such schedule(s) apply to various types or classes of retail customers, accounts or transactions. If a member negotiates or intends to negotiate with any retail customer to charge commissions that are lower than those in the applicable schedule(s), the member shall disclose that the member may charge certain retail customers commission rates that are lower than the commissions in the applicable schedule(s). A member shall provide in writing (which may be electronic) the schedule(s) to new retail customers at the opening of an account and to all retail customers at least once each calendar year. If a member changes a commission or any other information in the schedule(s), or adds a new form of commission charge for retail customers, a member shall provide in writing (which may be electronic) such changes to all retail customers at least 30 days prior to the date such changes take effect.

(2) In lieu of providing the schedule(s) of commission charges to retail customers as required under paragraph (e)(1) of this Rule, a member may make available such schedule(s) to retail customers by posting them on the member's website, if the member provides written notice (which may be electronic) to new retail customers at the opening of an account and to all retail customers at least once each calendar year of the manner in which they may access the schedule(s) and that, upon a retail customer's request, the member shall provide a copy of the schedule(s) to the customer. If a member changes a commission or any other information in the schedule(s), or adds a new form of commission charge for retail customers, the member shall provide written notice (which may be electronic) to all retail customers at least 30 days prior to the date such changes take effect, of the manner in which they may access the changes and that, upon a retail customer's request, the member shall provide a copy of the changes to the customer.

(3) For the purposes of this paragraph (e) of this Rule, the term "retail customer" means a customer that does not qualify as an "institutional account" under NASD Rule 3110(c)(4).

(f) Notice of "Missing the Market" and Consent to Commission Charge

A member that accepts an order for execution as agent and, by reason of neglect to execute the order or otherwise, trades with the customer as principal, shall not charge the customer a commission, without the knowledge and consent of the customer.

[IM-2440-2]2122. [Additional Mark-Up Policy] Markups and Markdowns [F]for Transactions in Debt Securities, Except Municipal Securities[1]

(a) Scope

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

(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] Rule, 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 FINRA [NASD] pricing rules. (*See, e.g.,* Rule [2320] 5310).

(2) When the dealer is *selling* the security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous purchases* in the security or can show that in the particular circumstances the dealer's *contemporaneous cost* is not indicative of the prevailing market price. When the dealer is *buying* the security from a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous sales* in the security or can show that in the particular circumstances the dealer's *contemporaneous proceeds* are not indicative of the prevailing market price.

(3) A dealer's cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark[-

]down is being calculated, a dealer's proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be expected to reflect the current market price for the security.)

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost (or, in a mark[-]down, the dealer's own proceeds) must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or, the dealer's proceeds) provides the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost is (or proceeds are) not indicative of prevailing market price, and thus overcome the presumption, in instances where (i) interest rates changed after the dealer's contemporaneous transaction to a degree that such change would reasonably cause a change in debt securities pricing; (ii) the credit quality of the debt security changed significantly after the dealer's contemporaneous transaction; or (iii) news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security after the dealer's contemporaneous transaction.

(5) In instances where the dealer has established that the dealer's cost is (or, in a mark[-]down, proceeds are) no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or proceeds) provides the best measure of the prevailing market price, such as those instances described in paragraphs (b)(4)(i), (ii) and (iii), a member must consider, in the order listed, the following types of pricing information to determine prevailing market price:

(A) Prices of any contemporaneous inter-dealer transactions in the security in question;

(B) In the absence of transactions described in subparagraph (A), prices of contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same security; or

(C) In the absence of transactions described in subparagraphs (A) and (B), for actively traded securities, contemporaneous bid (offer) quotations for the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations.

(A member may consider a succeeding category of pricing information only when the prior category does not generate relevant pricing information (e.g., a member may consider pricing information under subparagraph (B) only after the member has determined, after applying subparagraph (A), that there are no contemporaneous inter-dealer transactions in the same security)). In reviewing the pricing information available within each category, the relative weight, for purposes of identifying prevailing market price, of such information (*i.e*., either a particular transaction price, or, in subparagraph (C) above, a particular quotation) depends on the facts and circumstances of the comparison transaction or quotation (*i.e*., such as whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction and timeliness of the information).

(6) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration for the purpose

of establishing the price from which a customer mark[-]up (mark[-]down) may be calculated, include but are not limited to:

- Prices of contemporaneous inter-dealer transactions in a “similar” security, as defined below, or prices of contemporaneous dealer purchase (sale) transactions in a “similar” security with institutional accounts with which any dealer regularly effects transactions in the “similar” security with respect to customer mark[-]ups (mark[-]downs);

- Yields calculated from prices of contemporaneous inter-dealer transactions in “similar” securities;

- Yields calculated from prices of contemporaneous dealer purchase (sale) transactions with institutional accounts with which any dealer regularly effects transactions in “similar” securities with respect to customer mark[-]ups (mark[-]downs); and

- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in “similar” securities for customer mark[-]ups (mark[-]downs).

The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the factors set forth above depends on the facts and circumstances surrounding the comparison transaction (*i.e.*, whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, timeliness of the information, and, with respect to the final factor listed above, the relative spread of the quotations in the similar security to the quotations in the subject security).

(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) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering yields of "similar" securities, except in extraordinary circumstances, members may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in "similar" securities taken as a whole.

(9) "Customer," for purposes of [Rule 2440, IM-2440-1 and this IM-2440-2] this Rule and Rule 2121, shall not include a qualified institutional buyer ("QIB") as defined in Securities Act 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 Rule 2111 [IM-2310-3], 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, IM-2440-1 and this IM-2440-2] this Rule and Rule 2121, "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) A "similar" security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the "similar" security or securities. Where a security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

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

(A) Credit quality considerations, such as whether the security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as "similar" securities, significant recent information of either issuer that is

not yet incorporated in credit ratings should be considered (*e.g.*, changes to ratings outlooks));

(B) The extent to which the spread (*i.e.*, the spread over U.S. Treasury securities of a similar duration) at which the "similar" security trades is comparable to the spread at which the subject security trades;

(C) General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security; and

(D) Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security.

(3) When a debt security's value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, other securities may not be used to establish the prevailing market price.

[1] The [Interpretation] Rule does not apply to transactions in municipal securities. Single terms in parentheses within sentences, such as the term[s] "(sale)" [and "(to)"] in the phrase, "contemporaneous dealer purchase (sale) transactions with institutional accounts," refer to scenarios where a member is charging a customer a mark[-]down.

[2430]2123. Charges and Fees for Services Performed

(a) Reasonable Charges and Fees

Charges or fees, if any, for services performed, including miscellaneous services such as collection of monies due for principal, dividends, or interest; exchange or transfer of securities; appraisals;[,] safe-keeping or custody of securities[,] and other services[,] shall be reasonable and not unfairly discriminatory [between] among customers.

(b) Charges and Fees Schedules

(1) A member shall establish and make available to retail customers a schedule(s) of charges and fees for services performed for retail customers, which shall reflect the standard charges and fees of the member for such services. If a member makes available more than one schedule, the member shall disclose the manner in which such schedule(s) apply to various types or classes of retail customers, accounts or services. If a member negotiates or intends to negotiate with any retail customer to reduce any charges or fees below those in the applicable schedule(s), the member shall disclose that the member may charge certain retail customers charges and fees that are lower than the charges and fees in the applicable schedule(s). A member shall provide in writing (which may be electronic) the schedule(s) to new retail customers at the opening of an account and to all retail customers at least once each calendar year. If a member changes a charge, a fee or any other information in the schedule(s), or adds a new form of charge or fee for retail customers, a member shall provide in writing (which may be electronic) such changes to all retail customers at least 30 days prior to the date such changes take effect.

(2) In lieu of providing the schedule(s) of charges and fees for services performed to retail customers as required under paragraph (b)(1) of this Rule, a

member may make available such schedule(s) to retail customers by posting them on the member's website, if the member provides written notice (which may be electronic) to new retail customers at the opening of an account and to all retail customers at least once each calendar year of the manner in which they may access the schedule(s) and that, upon a retail customer's request, the member shall provide a copy of the schedule(s) to the customer. If a member changes a charge, a fee or any other information in the schedule(s), or adds a new form of charge or fee for retail customers, the member shall provide written notice (which may be electronic) to all retail customers at least 30 days prior to the date such changes take effect, of the manner in which they may access the changes and that, upon a retail customer's request, the member shall provide a copy of the changes to the customer.

(3) For the purposes of this paragraph (b) of this Rule, the term "retail customer" means a customer that does not qualify as an "institutional account" under NASD Rule 3110(c)(4).

* * * * *

Text of Incorporated NYSE Rule and Rule Interpretation to be Deleted in their Entirety from the Transitional Rulebook

* * * * *

Incorporated NYSE Rule

* * * * *

[Rule 375. Missing the Market]

[A member or member organization who has accepted an order for execution and who, by reason of neglect to execute the order or otherwise, takes or supplies for his or its own account, the securities named therein is not acting as a broker and shall not charge a commission, without the knowledge and consent of the customer.]

* * * * *

Incorporated NYSE Rule Interpretation

* * * * *

[Rule 375. Missing the Market]

[/01 Customer Contact and "As of" Reports]

[When a member organization has "missed the market" on a customer order, the customer should be contacted, informed of the circumstances, and given the choice of having the order filled at the price prevailing "as of" the time the market was missed or executed at the present market price.]

[If the customer elects to have the order filled at the "as of" price, the member organization may

- effect the transaction for the customer's account on the Floor and make a cash price adjustment; or
- fill the customer's order from the firm's error account.]

[The customer's confirmation shall carry the legend "as of" (date).]

* * * * *