Regulatory Notice 13-07

Markups, Commissions and Fees

FINRA Requests Comment on Proposed FINRA Rules Governing Markups, Commissions and Fees

Comment Period Expires: April 1, 2013

Executive Summary

As part of the process to develop a new, consolidated rulebook (the Consolidated FINRA Rulebook),[1] FINRA is requesting comment on proposed FINRA rules governing markups, markdowns, commissions and fees. FINRA initially sought comment on the proposed rules in *Regulatory Notice 11-08*. In response to the comments received, FINRA is proposing several changes to the proposed rules. These changes include, among other things, amendments to: (1) retain the 5% markup policy in NASD IM-2440-1 (Mark-Up Policy); (2) revise certain of the relevant factors used to determine the reasonableness of markups and commissions; (3) eliminate the requirement to provide commission schedules for equity securities transactions to retail customers; and (4) extend the proposed markup rules to transactions in certain government securities. This *Notice* requests comment on the revised proposal.

The text of the proposed rules can be found at *www.finra.org/notices/13-07*.

Questions regarding this *Notice* should be directed to:

- Sharon Zackula, Associate Vice President & Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8985; and
- Erika Lazar, Assistant General Counsel, OGC, at (202) 728-8013.

January 2013

Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management

Key Topics

- 5% Policy
- Commissions
- Government Securities
- Markups and Markdowns
- Rulebook Consolidation
- Service Charges and Fees

Referenced Rules & Notices

- FINRA Rule 0150
- FINRA Rule 2010
- FINRA Rule 2111
- NASD IM-2310-3
- NASD IM-2440-1
- NASD IM-2440-2
- NASD Rule 2430
- NASD Rule 2440
- NYSE Rule 375 and Interpretation 375/01
- Regulatory Notice 11-08
- SEA Section 3
- SEA Section 19

FINRA®
Financial Industry Regulatory Authority

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by April 1, 2013.

Comments must be submitted through one of the following methods:

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

  Marcia E. Asquith
  Office of the Corporate Secretary
  FINRA
  1735 K Street, NW
  Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.[2]

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).[3]

Background & Discussion

In *Regulatory Notice 11-08*, FINRA sought comment on an initial proposal regarding proposed FINRA Rules 2121 (Fair Prices and Markups, Markdowns and Commissions) and 2122 (Markups and Markdowns for Transactions in Debt Securities, Except Municipal Securities) governing markups, markdowns and commissions (the proposed markup rules), and proposed FINRA Rule 2123 (Charges and Fees for Services Performed) governing fees. The proposed FINRA rules are derived from NASD Rule 2440 (Fair Prices and Commissions), NASD IM-2440-1 (Mark-Up Policy), NASD IM-2440-2 (Additional Mark-Up Policy for Transactions in Debt Securities, Except Municipal Securities), NASD Rule 2430 (Charges for Services Performed), and Incorporated NYSE Rule 375 (Missing the Market).[4] FINRA received 25 comment letters in response to *Regulatory Notice 11-08*.[5] FINRA now seeks comments on a revised proposal.

Differences Between the Initial and Revised Proposals

The significant differences between the initial proposal and the revised proposal are set forth below; however, interested parties should carefully read the proposed rule text for a complete and detailed understanding of the revised proposal.

- The revised proposal amends proposed FINRA Rule 2121 to:
  - retain the 5% policy and related concepts from NASD IM-2440-1. In the initial proposal, FINRA proposed to delete the 5% policy and all related statements;
  - establish a rebuttable presumption that a markup, markdown or commission in excess of 5 percent is unfair and unreasonable;
  - modify the "relevant factors" that member firms should take into consideration in determining the fairness of a markup, markdown or commission to provide additional guidance and, in some instances, expand the scope of the factor; and
  - delete previously proposed FINRA Rule 2121(e), a requirement that member firms provide commission schedule(s) for equity securities transactions to retail customers.
- The revised proposal amends proposed FINRA Rule 2122 to update the criteria applicable to eligible qualified institutional buyers (QIB) purchasing or selling non-investment grade debt securities, whose transactions are excluded under the markup rules. The amendments would incorporate the standards regarding institutional suitability in FINRA Rule 2111(Suitability), rather than NASD IM-2310-3, which has been superseded.[6]
- The revised proposal amends proposed FINRA Rule 2123 to provide additional examples of charges and fees that are subject to the rule and include natural persons advised by an investment adviser and other natural persons as "retail customers" for the purposes of the rule.
- Finally, the revised proposal includes an amendment to FINRA Rule 0150 (Application of Rules to Exempted Securities Except Municipal Securities) that extends the proposed markup rules to transactions in government securities as defined in Exchange Act Section 3(a)(42) (excluding U.S. Treasury securities as defined in FINRA Rule 6710(p)).

Revised Proposal

A. Fair Prices and Markups, Markdowns and Commissions (Proposed FINRA Rule 2121)

Consistent with the initial proposal, FINRA proposes to consolidate and transfer NASD Rule 2440, NASD IM-2440-1 and NYSE Rule 375 to the Consolidated FINRA Rulebook as new FINRA Rule 2121. FINRA is proposing minor substantive changes to NASD Rule 2440 and NYSE Rule 375, and significant changes to NASD IM-2440-1.[7] As set forth in the initial proposal, FINRA proposes not to incorporate NYSE Rule Interpretation 375/01, which addresses the execution of an order when a member firm has missed the market, into the proposed markup rules.[8] The revised proposal includes additional substantive amendments to proposed FINRA Rule 2121, which are described in detail below.[9]

1. Fair and Reasonable Markups, Markdowns and Commissions (Proposed FINRA Rule 2121(a))

In general, NASD Rule 2440 requires that securities be sold to or purchased from customers at fair prices and, if a member firm acts as agent, be subject to fair commissions or commission-equivalent charges. Fairness is judged by the facts and circumstances of the particular transaction. NASD Rule 2440 also lists certain circumstances and factors that are relevant in determining a markup, markdown or commission.

Consistent with the initial proposal, FINRA proposes to transfer NASD Rule 2440 as proposed FINRA Rule 2121(a), subject to minor changes, to the Consolidated FINRA Rulebook. Proposed FINRA Rule 2121(a) requires, in any securities transaction, if a member firm acts as principal and buys for the member's account from its customer, or sells from the member's account to its customer, that the member firm must 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 firm is entitled to remuneration. If a member firm acts as agent for the member's customer in any securities transaction, the member firm must not charge its 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 the member firm may have rendered by reason of its experience in and knowledge of such security and the market for the security.

2. Retaining the "5% Policy" and Related Concepts (Proposed FINRA Rule 2121(b)(1))

NASD IM-2440-1 addresses the 5% policy. The preamble to NASD IM-2440-1 states that the question of fair markups (or spreads) is one for which there is no definitive answer or single interpretation because a markup that may be considered fair in one transaction could be unfair in another transaction, based on the different circumstances of the two transactions. The preamble also refers to a 1943 survey of the FINRA (then NASD) membership, in which 71 percent of respondents indicated that transactions were executed with markups of 5 percent or less.[10] The Board of Governors then determined that in most transactions, markups of 5 percent or less would fall within the "fair and reasonable" standard and adopted the 5% policy as guidance. In addition, NASD IM-2440-1(a) provides several general considerations, including statements that the 5% policy is a guide and not a rule and that a markup pattern of 5 percent or even less may be considered unfair or unreasonable under the 5% policy.

In the initial proposal, FINRA proposed to delete the 5% policy and to provide "Markup Threshold Guidance" in a separate *Regulatory Notice*, which would set forth quantitative guidance regarding markup, markdown and commission thresholds that, if exceeded, would be subject to additional regulatory scrutiny. A majority of the comments received on the initial proposal opposed the elimination of the 5% policy.[11] These commenters stated that the 5% policy generally has been effective in regulating broker-dealers for over 70 years and eliminating it would reduce investor protection, harm investors, and be interpreted by unscrupulous industry members as an invitation to charge excessive or abusive markups and commissions. These commenters urged FINRA to retain the 5% policy (or a similar quantitative standard) in the proposed markup rules because it helps firms in establishing effective supervisory and compliance procedures and setting upper benchmarks applicable to almost all transactions (*e.g.*, the 5% policy aids compliance personnel in surveillance efforts using automated tools, such as exception reports). The commenters also noted that it protects investors from excessive markups and commissions and assists them in challenging excessive markup and commission charges in arbitration and other proceedings. Several commenters suggested that the 5% policy should be revised to include an alternative quantitative standard if the current policy is outdated.

In light of the concerns raised by the comments on the initial proposal, FINRA proposes to retain the 5% policy as FINRA Rule 2121(b)(1).[12] Proposed FINRA Rule 2121(b)(1) incorporates the general considerations from NASD IM-2440-1(a) that the 5% policy is a guide, not a rule and that a markup pattern of 5 percent or less may be considered unfair or unreasonable under the 5% policy. In addition, proposed FINRA Rule 2121(b)(1) provides that when a member firm charges a markup, markdown or commission in excess of 5 percent, a presumption exists that it is unfair and unreasonable. A member firm may overcome the presumption by demonstrating that the markup, markdown or commission is fair and reasonable based on the relevant factors set forth in proposed FINRA Rule 2121(c),

which is based on NASD IM-2440-1(b). All relevant factors may be considered to determine if a member firm has rebutted the presumption; provided, however, the presumption may not be rebutted based solely on the member firm's disclosure to a customer of the firm's markup, markdown or commission (made in compliance with the revised disclosure requirements in proposed FINRA Rule 2121(c)(5)).

Notwithstanding the revised proposal to retain the 5% policy, FINRA recognizes that 5 percent is significantly higher than the average markup, markdown or commission currently charged by most member firms in customer transactions. Since 1943, advances in information and communication technologies, and member firms' front and back office technologies, have significantly reduced execution costs. As a result, markups, markdowns and commissions also have decreased in many investment products. In addition, customers generally have multiple execution options, and competition among market professionals has driven down the amount of markup, markdown or commission a member firm will charge. Accordingly, although proposed FINRA Rule 2121 would retain the 5% policy, member firms should not view the provision as establishing a specific ceiling or cap below which most markups, markdowns or commissions will not be viewed as excessive (or will not be questioned).

3. Other General Considerations (Proposed FINRA Rules 2121(b)(2) through (b)(5))

Consistent with the initial proposal, the revised proposal transfers to FINRA Rule 2121(b) (General Considerations) the general considerations in NASD IM-2440-1(a)(2) and (a)(5) with minor changes. The revised proposal transfers NASD IM-2440-1(a)(3) and (c)(2) with clarifying changes that were not included in the initial proposal.[13]

- Proposed FINRA Rule 2121(b)(2), based on NASD IM-2440-1(a)(2), provides that a member firm may consider its expenses, but shall not justify markups, markdowns or commissions on the basis of expenses that are excessive.
- Proposed FINRA Rule 2121(b)(3), based on NASD IM-2440-1(a)(3), provides that the difference between the customer's price (including the markup or markdown) and the prevailing market price is the amount (or percentage) to be considered when determining if a member firm has dealt fairly with its customer in a principal transaction. Unless other bona fide, more credible evidence of the prevailing market price can be evidenced, for a markup, a member firm's own contemporaneous cost is the best indication of the prevailing market price of a security, and for a markdown, a member firm's own contemporaneous proceeds are the best indication of the prevailing market price of a security.
- Proposed FINRA Rule 2121(b)(4), based on NASD IM-2440-1(c)(2), provides that except in riskless principal trades or nearly contemporaneous trades in which a security is held in a member's inventory very briefly, if a member firm sells a security to a customer

from inventory, the amount of the markup would be determined on the basis of the markup over the bona fide representative current market price, and the profit or loss to the member firm 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.

- Proposed FINRA Rule 2121(b)(5), based on NASD IM-2440-1(a)(5), provides that a determination of the fairness of a markup, markdown or commission must be based on a consideration of all the relevant factors, of which the percentage of markup, markdown or commission is only one.

4. Relevant Factors (Proposed FINRA Rule 2121(c))

In the initial proposal, FINRA proposed to transfer as FINRA Rule 2121(c) (Relevant Factors) the non-exclusive list of seven relevant factors in NASD IM-2440-1(b) that a member firm should take into consideration in determining if a markup, markdown or commission is fair and reasonable. FINRA now proposes minor changes to three of the factors to provide additional guidance and, in some cases, to expand the scope of the factor:

- In the initial proposal, FINRA Rule 2121(c)(2) (The Availability of the Security in the Market), based on NASD IM-2440-1(b)(2), stated that, 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 be a factor in determining the amount (or percentage) of the markup, markdown or commission. The revised proposal expands this provision to provide that the effort and cost of buying or selling a security may be a factor in determining the amount (or percentage) of a markup, markdown or commission if a security is difficult to locate or source, is inactive or infrequently traded, is subject to market liquidity restraints relative to the size of the transaction sought to be executed, or if there are unusual circumstances connected with a security's acquisition or sale, *e.g.*, the security is acquired through a foreign intermediary.
- In the initial proposal, FINRA Rule 2121(c)(4) (The Amount of Money Involved in a Transaction), based on NASD IM-2440-1(b)(4), stated that a transaction that involves a small amount of money may warrant a higher percentage of markup, markdown or commission to cover expenses of handling. The revised proposal adds language to provide that a transaction that involves a large amount of money may warrant a lower percentage of markup, markdown or commission where the expenses of handling the transaction do not rise by virtue of the size of the transaction.
- In the initial proposal, FINRA Rule 2121(c)(5) (Disclosure), based on NASD IM-2440-1(b)(5), stated that where a member discloses the amount of the commission charged in an agency transaction, or the markup 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. The revised proposal clarifies that for disclosure to be considered in determining if a member deals fairly with a

customer, a member firm must disclose the total dollar amount and percentage of the commission charged in an agency transaction, or the total dollar amount and percentage of markup or markdown made in a principal transaction to a customer before the transaction is effected. Consistent with the initial proposal, disclosure itself does not justify a markup, markdown or commission that is unfair or unreasonable in light of all other relevant facts and circumstances surrounding the transaction.

Consistent with the initial proposal, FINRA proposes to transfer to FINRA Rule 2121(c) the following four factors with minor, stylistic changes:

- NASD IM-2440-1(b)(1) would transfer as proposed FINRA Rule 2121(c)(1) (The Type of Security Involved);
- NASD IM-2440-1(b)(3) would transfer as proposed FINRA Rule 2121(c)(3) (The Price of the Security);
- NASD IM-2440-1(b)(6) would transfer as proposed FINRA Rule 2121(c)(6) (The Pattern of Markups); and
- NASD IM-2440-1(b)(7) would transfer as proposed FINRA 2121(c)(7) (The Nature of the Member's Business).

5. Transactions to Which the Rule is Not Applicable (Proposed FINRA Rule 2121(d))

Consistent with the initial proposal, FINRA Rule 2121(d) provides that FINRA Rule 2121 is not applicable to: (1) the sale of securities where a prospectus or offering circular must be delivered and the securities are sold at the specific public offering price, based on NASD IM-2440-1(d); and (2) a transaction in a non-investment grade debt security with a QIB that meets the conditions set forth in proposed FINRA Rule 2122(b)(9), which is described below.

6. Deletion of the "Proceeds Provision"

When a customer sells one security and buys a second security at the same time, using the proceeds of the securities position liquidated to pay for the second position, the "proceeds provision" in NASD IM-2440-1(c)(5) requires that both trades be treated as a single transaction for markup, markdown and commission purposes, with the result that the total remuneration for both transactions generally cannot exceed the remuneration amount for a single transaction. Consistent with the initial proposal, FINRA proposes not to incorporate the proceeds provision in NASD IM-2440-1(c)(5) in the proposed markup rules.

FINRA received eight comment letters opposing the elimination of the proceeds provision and two comment letters in favor of eliminating it.[14] The commenters that opposed deleting the proceeds provision stated that the provision prevents member firms from "double dipping," serves as a deterrent to churning and, if deleted, would encourage unscrupulous broker-dealers to engage in serial transactions to generate maximum commission income. Some of the commenters suggested that FINRA clarify the proceeds provision, or provide guidance, instead of deleting it.

FINRA has carefully considered the comments and continues to believe that the proceeds provision should not be incorporated in the proposed markup rules because it includes a standard that is not susceptible to consistent and fair application.[15] In FINRA's view, the more practical approach is to determine transaction remuneration on a fair basis for each transaction and to address the commenters' concerns by continuing to monitor accounts for possible churning and other fraudulent trading, or trading that is in violation of just and equitable principles of trade.

7. Deletion of Initial Proposal Regarding Commission Schedules (Proposed FINRA Rule 2121(e))

FINRA Rule 2121(e) in the initial proposal added a new requirement to the markup rules regarding transaction-based remuneration. In general, the proposed provision required member firms to establish and make available to retail customers the schedule(s) of standard commission charges for transactions in equity securities with retail customers. Commenters on the initial proposal objected to the new requirement stating, among other things, that the requirement would be duplicative of information currently provided to customers, commissions vary widely by account type, posting commission schedules would set a floor instead of fostering competition, and posting commission schedules would be counter-productive in this era of negotiated commissions.[16] In light of the commenters' concerns, FINRA proposes to delete the proposed requirement.

8. Notice of "Missing the Market" and Consent to Commission Charge (Proposed FINRA Rule 2121(e))

In the initial proposal, FINRA proposed to incorporate NYSE Rule 375 as proposed FINRA Rule 2121(f) (Notice of "Missing the Market" and Consent to Commission Charge) with minor changes in the Consolidated FINRA Rulebook. In the revised proposal, the provision is renumbered as proposed FINRA Rule 2121(e) and, consistent with the initial proposal, provides that a member firm 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.[17]

B. Markups and Markdowns for Transactions in Debt Securities, Except Municipal Securities (Proposed FINRA Rule 2122)

NASD IM-2440-2 addresses: (1) additional standards applicable to the determination of a markup or a markdown in a transaction with a customer in a debt security; (2) the procedures to identify prevailing market price; (3) the role of the dealer's contemporaneous cost in determining prevailing market price; and (4) characteristics of "similar securities" and the role of similar securities in determining a markup or a markdown. In the initial proposal, FINRA proposed to transfer NASD IM-2440-2 to the Consolidated FINRA Rulebook as proposed FINRA Rule 2122 without significant changes.[18] FINRA now proposes to incorporate the following additional amendments.

In proposed FINRA Rule 2122(b)(5) and proposed FINRA Rule 2122(b)(6), based on NASD IM-2440-2(b)(5) and (b)(6), FINRA proposes to clarify several statements in the existing provisions that apply when a dealer looks to alternative measures to determine the prevailing market price of a security that the dealer purchases from, or sells to, a customer.

In the initial proposal, FINRA Rule 2122(b)(9), based on NASD IM-2440-2(b)(9), provided that member firms engaged in customer transactions that meet the following conditions are not subject to the requirements governing markups and markdowns for such transactions: (1) the transaction is effected with a QIB;[19] (2) the transaction involves a non-investment grade debt security;[20] and (3) the dealer has determined, after considering the factors set forth in NASD IM-2310-3 (Suitability Obligations to Institutional Customers), 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. The revised proposal updates the third criterion in proposed FINRA Rule 2122(b)(9) to delete references to NASD IM-2310-3, which was rescinded on July 9, 2012, align the criterion with the standards regarding institutional suitability in FINRA Rule 2111(Suitability), which took effect on July 9, 2012,[21] and expand the standards to apply to an authorized agent of a QIB.

Specifically, under the revised proposal, the third criterion requires that a dealer have a reasonable basis to believe that a QIB purchasing or selling a non-investment grade debt security is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities, and the QIB affirmatively must indicate that it is exercising independent judgment in deciding to enter into the transaction. In addition, if a QIB has delegated decision-making authority to an agent, such as an investment adviser or a bond trust department, the factors would be applied to the agent.

C. Charges and Fees for Services Performed (Proposed FINRA Rule 2123)

NASD Rule 2430 requires that charges and fees for services must be reasonable and not unfairly discriminate among customers, and it applies to all charges and fees for services provided by a member firm that are not related to the execution of a transaction.

In the initial proposal, and as described in more detail in *Regulatory Notice 11-08*, FINRA proposed to adopt NASD Rule 2430 as FINRA Rule 2123 (Charges and Fees for Services Performed) in the Consolidated FINRA Rulebook with a significant change to require member firms to establish and make available to retail customers their schedule(s) of standard charges and fees for services. The initial proposal defined a retail customer as a customer that does not qualify as an "institutional account" as defined in Rule 4512(c).[22] The revised proposal makes two changes to proposed FINRA Rule 2123.

The revised proposal provides in proposed FINRA Rule 2123(a) additional examples of charges and fees for miscellaneous services performed that are subject to the proposed rule, including charges and fees for setting up a new account, research, customer portfolio analysis, tax advice and calculation of required minimum distribution. In addition, the revised proposal modifies the definition of a "retail customer" in proposed FINRA Rule 2123(b), which requires that disclosures regarding charges and fees be made to retail customers. Under the modified definition, a retail customer would mean a customer that does not qualify as an "institutional account" as defined in Rule 4512(c), except any natural person or any natural person advised by a registered investment adviser.

D. Application of the Proposed Markup Rules to Transactions in Government Securities (FINRA Rule 0150)

FINRA Rule 0150(c) enumerates the FINRA and NASD rules that apply to transactions in, and business activities relating to, exempted securities, except municipal securities, conducted by member firms. The rule does not include the current markup rules[23] and, in general, cases alleging excessive markups, markdowns or commissions in transactions in exempted securities, other than municipal securities, are brought under FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade).[24]

In the revised proposal, FINRA proposes to amend FINRA Rule 0150 (Application of Rules to Exempted Securities Except Municipal Securities) to extend the proposed markup rules to transactions in government securities (as defined in Exchange Act Section 3(a)(42)), except U.S. Treasury securities (as defined in FINRA Rule 6710(p)).[25] Extension of the proposed markup rules to transactions in government securities is consistent with action contemplated since the SEC's 1996 Approval Order, approving the application of certain FINRA (then NASD) rules to transactions in exempted securities, other than municipal securities.[26] In addition, FINRA collects extensive information about government securities (*i.e.*, agency debentures and agency asset-backed securities), other than U.S. Treasury securities, in TRACE trade reports, and actively surveils the markets in such securities.

Market Makers

FINRA notes that proposed FINRA Rules 2121 and 2122 (like the current markup rules) do not address a market maker's allowance, subject to the limitations in regulation, to capture the trading spread between the bid and the ask prices and nothing in proposed FINRA Rules 2121 and 2122 affects that body of law and regulation.

Endnotes

1. 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 member firms, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The FINRA Rules apply to all FINRA member firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, *see* Information Notice 03/12/08 (Rulebook Consolidation Process). For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

2. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See* Notice to Members 03-73 (November 2003) (NASD Announces Online Availability of Comments) for more information.

3. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.

4. NASD Rule 2440, NASD IM-2440-1, and NASD IM-2440-2 govern markups, markdowns and commissions in transactions with customers. Fees or charges that are not transaction-related (*e.g.*, charges for safekeeping or collecting dividends or interest for a customer) are governed by NASD Rule 2430 (Charges for Services Performed). NYSE Rule 375 (Missing the Market) addresses instances where, by reason of neglect to execute the order or otherwise, a member firm takes or supplies for its own account the securities named in the order. The rules are summarized in Regulatory Notice 11-08.

5. The comments received in response to *Regulatory Notice 11-08* are available on FINRA's website at www.finra.org/notices/11-08.

6. FINRA Rule 2111 took effect on July 9, 2012, and superseded NASD Rule 2310 (Recommendations to Customers (Suitability)), NASD IM-2310-1 (Possible Application of SEC Rules 15g-1 through 15g-9), NASD IM-2310-2 (Fair Dealing with Customers), and NASD IM-2310-3 (Suitability Obligations to Institutional Customers).

7. NASD Rule 2440, NASD IM-2440-1 and NYSE Rule 375 would be deleted with the adoption of proposed FINRA Rule 2121.

8. As discussed in more detail in *Regulatory Notice 11-08*, FINRA would delete NYSE Rule Interpretation 375/01, which provides that a member firm that has "missed the market" should contact the customer, inform the customer of the circumstances and permit the customer to choose one of two ways that the member firm then will use to fill the order.

9. This *Notice* does not address certain amendments discussed in *Regulatory Notice 11-08* that are not changing under the revised proposal. For example, consistent with the initial proposal, FINRA proposes several conforming changes to FINRA Rule 2121 to add the term "reasonable" when referring to markups, markdowns and commissions that must be "fair" to incorporate the more widely used phrase "fair and reasonable."

10. The results are based on the 82 percent of the membership that responded to the survey.

11. *See, e.g.*, Law Office of Scott T. Beall (Beall), Law Office of Steve A. Buchwalter, P.C. (Buchwalter), Churchill Financial, LLC (Churchill), Compliance-by-Proxy (CBP), Cornell Securities Law Clinic (Cornell), Barry D. Estell (Estell), William Gladden (Gladden), Ledbetter & Associates P.A. (Ledbetter), North American Securities Administrators Association (NASAA), Public Investors Arbitration Bar Association (PIABA), Jeffrey R. Sonn, Esq. (Sonn), St. John's School of Law Clinic (St. John's), and Wells Fargo Advisors (WFA). Six commenters favored retiring the 5% policy. *See* letters from Securities Industry and Financial Markets Association (SIFMA), Financial Services Institute (FSI), Cambridge Investment Research (Cambridge), JW Korth, Moloney Securities, Inc. (Moloney), and National Planning Holdings, Inc. (NPH). However, three of the commenters, SIFMA, FSI and Cambridge, stated that the 5% policy should not be withdrawn unless FINRA provided to the membership, before or at the same time, the "Markup Threshold Guidance" or similar guidance.

12. In light of the proposal to retain the 5% policy, FINRA does not intend at this time to provide "Markup Threshold Guidance" in a separate *Regulatory Notice*.

13. FINRA Rule 2121(b)(1) through (b)(4) as initially proposed would be renumbered, respectively, as proposed FINRA Rule 2121(b)(2) through (b)(5).

14. *See* letters from Beall, Buchwalter, Cornell, Estell, Gladden, Ledbetter, NASAA, and PIABA opposing the deletion of the proceeds provision. *See* letters from SIFMA and Roberts & Ryan Investments, Inc. (R&R) in favor of deleting the provision.

15. For example, it is not always clear when two transactions occurring close in time are related (the two transactions may represent unrelated investment decisions) or how close in time transactions must be to be considered "proceeds" transactions. In addition, the proceeds provision may not be applied when a customer decides to sell a position at one member firm and purchase a position at another member firm.

16. *See, e.g.*, letters from Cambridge, CBP, Churchill, FSI, Moloney, NPH, Regal Bay Investment Groups, R&R, SIFMA, and WFA opposing the requirement to provide equity commission schedules to retail customers; letter from Juanita D. Hanley noting certain limitations of the proposed requirement; and letters from Cornell, St John's, NASAA, and Sonn supporting the proposed requirement.

17. Proposed FINRA Rule 2121(e) would be a new requirement for former NASD-only members. As discussed in the initial proposal, FINRA proposes to transfer these requirements because there are no similar requirements in the NASD markup rules regarding whether, and under what circumstances, a member firm may charge a commission if a member "misses the market."

18. NASD IM-2440-2 would be deleted with the adoption of FINRA Rule 2122.

19. *See* 17 CFR § 230.144A(a)(1).

20. For the purpose of the rule, the proposal would adopt the definition of "non-investment grade debt security" in NASD IM-2440-2(b)(9) with no change.

21. *See supra* note 6.

22. NASD Rule 2430 would be deleted with the adoption of FINRA Rule 2123. *See* Regulatory Notice 11-08. *See also Notice to Members 92-11* (Fees and Charges for Services).

23. This is largely for historical reasons. The Government Securities Act Amendments of 1993 (GSAA) eliminated the statutory limitations on NASD's authority to apply sales practice rules to transactions in exempted securities, except municipal securities. NASD undertook to review the specific application of certain of its rules, including the NASD markup rules then in effect (Rules 2440 and IM-2440-1), to the government securities market. *See* Notice to Members 96-66 (October 1996). NASD IM-2440-2 (the debt markup interpretation) – approved in 2007 – had not been adopted at the time FINRA Rule 0150 (then NASD Rule 0116) went into effect. *See* Securities Exchange Act Release No. 44631 (July 31, 2001), 66 FR 41283 (August 7, 2001) (Order Approving File No. SR-NASD-2000-038 (NASD Rule 0116)); *see also* Securities Exchange Act Release No. 55638 (April 16, 2007), 72 FR 20150 (April 23, 2007) (Order Approving File No. SR-NASD-2003-141 (NASD IM-2440-2)).

24. In Notice to Members 96-66, FINRA noted that actions for conduct generally encompassed by the NASD markup rules, among others, in the government securities market may be brought under FINRA Rule 2010. *See also* Securities Exchange Act Release No. 37588 (August 20, 1996), 61 FR 44100 (August 27, 1996) (Order Approving File No. SR-NASD-95-39) (1996 Approval Order).

25. "U.S. Treasury security" is defined in FINRA Rule 6710(p) to mean a security issued by the U.S. Department of the Treasury to fund the operations of the federal government or to retire such outstanding securities.

26. *See supra* note 24, the 1996 Approval Order at 61 FR 44104.