

# Notices

## Regulatory Notices

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## SEC Broker-Dealer Reporting Rules

### FINRA Announces Updates of the Interpretations of Financial and Operational Rules

#### Executive Summary

FINRA is updating the imbedded text of Securities Exchange Act (SEA) reporting rules for broker-dealers in the Interpretations of Financial and Operational Rules to reflect the effectiveness of amendments the SEC adopted.<sup>1</sup> The updated imbedded text relates to SEA Rules 17a-5 and 17a-11. FINRA is also making available related updates of the Interpretations of Financial and Operational Rules that have been communicated to FINRA staff by the staff of the SEC's Division of Trading and Markets (SEC staff). The updated interpretations relate to SEA Rule 17a-5.

Questions concerning this *Notice* should be directed to:

- ▶ Yui Chan, Managing Director, Risk Oversight and Operational Regulation (ROOR), at (646) 315-8426; or
- ▶ Susan DeMando Scott, Associate Vice President, ROOR, at (240) 386-4620.

#### Background & Discussion

In July 2013, the SEC adopted amendments to the reporting rules for broker-dealers. FINRA is updating the imbedded SEC rule text in the Interpretations of Financial and Operational Rules to reflect the amendments that became effective on June 1, 2014.<sup>2</sup> The updated imbedded text relates to SEA Rules 17a-5 and 17a-11. The interpretation updates resulting from the SEC's July 2013 amendments to SEA Rule 17a-5 are set forth below. Page references are to the hardcopy version. These interpretations are being updated with specific additions, revisions and rescissions.

#### June 2014

##### Notice Type

- ▶ Guidance

##### Suggested Routing

- ▶ Compliance
- ▶ Finance
- ▶ Legal
- ▶ Operations
- ▶ Regulatory Reporting
- ▶ Senior Management

##### Key Topics

- ▶ Books and Records
- ▶ Notification Provisions

##### Referenced Rules & Notices

- ▶ Regulatory Notice 08-56
- ▶ Regulatory Notice 13-44
- ▶ Regulatory Notice 14-06
- ▶ Regulatory Notice 14-12
- ▶ SEA Rule 17a-5
- ▶ SEA Rule 17a-11

The following interpretation has been **revised**:

- ▶ SEA Rule 17a-5(m)(1)/01 (Audit Extension Request) on page 3281.

The following interpretation has been **rescinded**:

- ▶ SEA Rule 17a-5(c)(2)/01 (Additional Time on Sending Audited and Unaudited Statements to Customers) on page 3222.

These rule text and interpretation updates are available in portable digital format (PDF) on FINRA's [Interpretations of Financial and Operational Rules](#) page.

Further, SEC staff continues to communicate and issue written and oral interpretations of the financial responsibility and reporting rules including the newly amended sections of the rules. FINRA has previously updated the Interpretations of Financial and Operational Rules on its website in [Regulatory Notices 08-56, 13-44, 14-06](#) and [14-12](#).

FINRA member firms and others that maintain the hardcopy version of the Interpretations of Financial and Operational Rules may refer to the accompanying [updated pages](#), containing the aforementioned rule text updates, which are being made available to enable the replacement of existing pages in the hardcopy version of the Interpretations of Financial and Operational Rules. The filing instructions for the new pages are as follows:

SEA Rule	Remove Old Pages	Add New Pages
17a-5	3201-3284	3201-3284
17a-11	3301-3304	3301-3304

## Endnotes

1. See Securities Exchange Act Release No. 70073 (July 30, 2013), 78 FR 51910 (August 21, 2013) (Broker-Dealer Reports).
2. See note 1.

## Prohibition on Payments for Market Making

### New Payments for Market Making Certification Requirement for FINRA Form 211

Effective Date: July 7, 2014

#### Executive Summary

FINRA is issuing this *Regulatory Notice* to remind firms and associated persons of the FINRA Rule 5250 (Payments for Market Making) prohibition on accepting payments for market making, which includes payments for filing a Form 211 pursuant to FINRA Rule 6432 (Compliance with the Information Requirements of SEA Rule 15c2-11). This *Notice* also announces the July 7, 2014, effective date of a new requirement under Rule 6432 that firms certify that neither the firm nor its associated persons have accepted or will accept any payment or other consideration prohibited by Rule 5250.<sup>1</sup>

Questions regarding this *Notice* should be directed to Racquel Russell, Associate General Counsel, Office of General Counsel, at (202) 728-8363.

#### Background and Discussion

Rule 5250 prohibits firms and their associated persons from accepting any payment or other consideration, directly or indirectly, from an issuer of a security, or any affiliate or promoter thereof, for publishing a quotation, acting as market maker in a security, or submitting an application in connection therewith. Rule 5250 is intended to, among other things, assure that a firm acts in an independent capacity when publishing a quotation or making a market in an issuer's securities. The Rule 5250 prohibition on receiving payments for market making includes within its scope the receipt of payments for submitting a Form 211 to FINRA pursuant to Rule 6432, which sets forth the standards applicable to firms for demonstrating compliance with SEA Rule 15c2-11 and must be complied with prior to initiating or resuming quotations in a quotation medium.

#### June 2014

##### Notice Type

- ▶ Guidance
- ▶ Rule Amendment

##### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Systems
- ▶ Trading and Market Making
- ▶ Training

##### Key Topics

- ▶ Form 211
- ▶ Market Making
- ▶ Payments for Market Making
- ▶ SEA Rule 15c2-11

##### Referenced Rules & Notices

- ▶ FINRA Rule 2020
- ▶ FINRA Rule 5250
- ▶ FINRA Rule 6432
- ▶ NTM 75-16
- ▶ SEA Rule 15c2-11
- ▶ Securities Act Section 5

Rule 6432 generally requires firms to review and attach specified information concerning the issuer whose security is being quoted in a quotation medium. This information includes, as applicable, a recent prospectus, the issuer's most recent annual and periodic reports or other financial information, the price at which the security will be quoted and the basis thereof.<sup>2</sup> Form 211 also asks the firm to certify that the responsible principal has a reasonable basis for believing that the information accompanying the Form 211 is accurate in all material respects and obtained from a reliable source.

FINRA is reminding firms that accepting monetary compensation or receiving shares of stock in connection with publishing a quotation, including, but not limited to, the filing of a Form 211 with FINRA, is expressly prohibited by Rule 5250, irrespective of whether such payments are solicited or unsolicited. Accepting such prohibited payments compromises the independence of a firm's decision regarding its quoting and market making activities and, among other things, harms investor confidence in the overall marketplace because investors are unable to ascertain which quotations are based on actual interest and which quotations are supported by issuers or promoters.<sup>3</sup>

To further emphasize firms' obligations in this area, FINRA has adopted an additional certification under Rule 6432 that requires firms to certify to FINRA that neither the firm nor its associated persons have accepted or will accept any payment or other consideration, directly or indirectly, from the issuer of the security to be quoted, or any affiliate or promoter thereof, for publishing a quotation or acting as market maker in the security to be quoted, or submitting an application in connection therewith, including the submission of the Form 211.<sup>4</sup>

The new certification will be included in the Form 211 beginning on July 7, 2014.<sup>5</sup> Only firms submitting a form pursuant to Rule 6432 going forward will be required to submit the new certification, though FINRA notes that the prohibition on accepting payments for market making already is applicable to firms and associated persons.<sup>6</sup>

## Endnotes

1. See Securities Exchange Act Release No. 71720 (March 13, 2014), 79 FR 15363 (March 19, 2014) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2014-011).
2. As stated in *Notice to Members 75-16* (February 1975), payments for market making may be viewed as a conflict of interest since they may influence the firm's decision as to whether to quote or make a market in a security and, thereafter, the prices that the firm would quote.
3. See Securities Exchange Act Release No. 38812 (July 3, 1997), 62 FR 37105 (July 10, 1997) ("Order Approving File No. SR-NASD-97-29"). The rule prohibits indirect payments by the issuers, affiliates, or promoters through other members. Therefore, firms may not accept payments from other firms that originate from an issuer, affiliate or promoter of the issuer. See Order Approving File No. SR-NASD-97-29.
4. FINRA continues to believe a market maker should have considerable latitude and freedom to make or terminate market making activities in an issuer's securities. The decision by a firm to make a market in a given security and the question of price generally are dependent on a number of factors, including, among others, supply and demand, the firm's expectations toward the market, its current inventory position, and exposure to risk and competition. The decision, however, should not be influenced by payments to the firm by the issuer. FINRA's policy concerning payments for market making was first set forth in *Notice to Members 75-16* and then codified as NASD Rule 2460 (now FINRA Rule 5250) in 1997. See *Notice to Members 75-16* (February 1975), [\*Notice to Members 97-46\*](#) (August 1997) and Order Approving File No. SR-NASD-97-29.
5. The Exemption Request Form pursuant to Rule 6432 also will include the new certification.
6. Firms should be mindful that charging an issuer a fee for making a market, or accepting an unsolicited payment from an issuer where the firm makes a market in the issuer's securities, could also subject the firm to violations of the anti-fraud provisions of federal securities laws and FINRA Rule 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices). See Order Approving File No. SR-NASD-97-29. FINRA Rule 2020 provides that no firm shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance. A payment by an issuer to a market maker to facilitate market making activities also could involve the firm in potential violations of the registration requirements of Section 5 of the Securities Act of 1933. See Order Approving File No. SR-NASD-97-29.

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## Protecting Personal Confidential Information in Arbitration Cases

### SEC Approves Amendments to Codes of Arbitration Procedure to Require Redaction of Personal Confidential Information from Documents Filed With FINRA Dispute Resolution

Effective Date: July 28, 2014

#### Executive Summary

The SEC approved amendments to the Customer and Industry Codes of Arbitration Procedure to provide that any document that a party files with FINRA that contains an individual's Social Security number, taxpayer identification number or financial account number must be redacted to include only the last four digits of any of these numbers.<sup>1</sup> The amendments apply only to documents filed with FINRA. They do not apply to documents that parties exchange with each other or submit to the arbitrators at a hearing on the merits. In addition, the amendments do not apply to cases administered under the Simplified Arbitration rules.

The amendments are effective on July 28, 2014, for all documents filed with FINRA on or after the effective date.

The text of the amendments is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- ▶ Richard W. Berry, Senior Vice President and Director of Case Administration, Operations, and Regional Office Services, Dispute Resolution, at (212) 858-4307 or [richard.berry@finra.org](mailto:richard.berry@finra.org); or
- ▶ Margo A. Hassan, Assistant Chief Counsel, Dispute Resolution, at (212) 858-4481 or [margo.hassan@finra.org](mailto:margo.hassan@finra.org).

#### June 2014

##### Notice Type

- ▶ Rule Amendment

##### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Registered Representatives

##### Key Topics

- ▶ Arbitration
- ▶ Codes of Arbitration Procedure
- ▶ Redacting Personal Confidential Information

##### Referenced Rules & Notices

- ▶ FINRA Rule 12300
- ▶ FINRA Rule 12307
- ▶ FINRA Rule 13300
- ▶ FINRA Rule 13307
- ▶ FINRA Rule 12800
- ▶ FINRA Rule 13800

## Background & Discussion

During an arbitration proceeding, parties submit pleadings and supporting documents to FINRA Dispute Resolution (DR) that may contain an individual's Social Security number, taxpayer identification number, or financial account number (personal confidential information or PCI). For example, customers often file account opening documents and account statements, which show their account numbers. Since FINRA employees regularly handle and transmit party documents containing PCI, FINRA has procedures in place to guide staff and arbitrators on how to keep confidential information safe. These procedures have enhanced the security of party documents and information. In an effort to further protect parties from identity theft and accidental loss of PCI, FINRA amended the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes to require parties to redact specified PCI from documents they file with FINRA.

Specifically, FINRA amended Rules 12300 and 13300 (Filing and Serving Documents) to provide that, in an electronic or paper filing with FINRA, any document that contains an individual's Social Security number, taxpayer identification number, or financial account number must be redacted to include only the last four digits of any of these numbers. The rules specify that a party must not include full numbers. If FINRA receives a claim,<sup>2</sup> including supporting documents, with a full Social Security, taxpayer identification or financial account number, FINRA will deem the filing deficient under Rule 12307 or Rule 13307 (Deficient Claims), as applicable, and will request that the party refile the document without the PCI within 30 days from the time the party receives notice. If a party files a document with PCI that is not covered by Rules 12307 or 13307 (a document other than a claim, such as a motion), FINRA will deem the filing to be improper and will request that the party refile the document, with the required redaction, within 30 days from the time the party receives notice. If the party refiles the document in compliance with the rules, FINRA will consider the document to be filed on the date the party initially filed it with FINRA.

There are two exceptions to the new redaction requirements. The amendments apply only to documents that parties file with FINRA (either in hard copy or electronically through, for example, the DR Portal). They do not apply to documents that parties exchange with each other, or submit to the arbitrators at a hearing on the merits. In addition, the amendments do not apply to cases administered under FINRA's Simplified Arbitration Rules 12800 and 13800.

To further protect themselves from the risk of identity theft, parties can agree to additional measures to protect PCI in the documents they share. For example, parties can agree not to use, or to redact driver license numbers and birthdates. Additionally, parties can agree to redact the entire Social Security number, taxpayer identification number or financial account number, if that is their preference. Finally, parties can use secure shredding facilities to safely dispose of documents they use at hearings.

## Effective Date

The amendments are effective on July 28, 2014, for all documents filed with FINRA on or after the effective date.

## Endnotes

1. See Securities Exchange Act Rel. No. 72269 (May 28, 2014), 79 Federal Register 32003 (June 3, 2014) (File No. SR-FINRA-2014-008).
2. The term claim means an allegation or request for relief and includes counterclaims, cross claims and third party claims.

## Attachment A

New language is underlined; Deletions are in brackets.

### Customer Code

#### 12300. Filing and Serving Documents

(a) – (f) No change

(g)(1) In an electronic or paper filing with FINRA, any document that contains an individual's Social Security number, taxpayer identification number or financial account number must be redacted to include only the last four digits of any of these numbers; a party shall not include the full numbers. If FINRA receives a claim, including supporting documents, with the full Social Security number, taxpayer identification number or financial account number, FINRA will deem the filing deficient under Rule 12307 and will request that the party refile the document in compliance with this paragraph. If a party files with FINRA any document not covered by Rule 12307, that contains full numbers as referenced above, FINRA will deem the filing improper and will request that the party refile the document within 30 days from the time the party receives notice. If a party refiles the document, the corrected documents will be considered filed on the date the party initially filed the documents with FINRA.

(2) The requirements of paragraph (g)(1) above do not apply to electronic or paper documents that parties exchange with each other and do not file with FINRA or to documents parties submit to a panel at a hearing on the merits.

(3) The requirements of paragraphs (g)(1) above do not apply to Simplified Arbitrations under Rule 12800.

### 12307. Deficient Claims

(a) The Director will not serve any claim that is deficient. The reasons a claim may be deficient include the following:

- A Submission Agreement was not filed by each claimant;
- The Submission Agreement was not properly signed and dated;
- The Submission Agreement does not name all parties named in the claim;
- The claimant did not file the correct number of copies of the Submission Agreement, statement of claim or supporting documents for service on respondents and for the arbitrators;
- The claim does not specify the customer's home address at the time of the events giving rise to the dispute;
- The claim does not specify the claimant's or the claimant's representative's current address; [or]
- The claimant did not pay all required filing fees, unless the Director deferred the fees; or
- The claim does not comply with the restrictions on filings with personal confidential information under Rule 12300(g).

(b) The Director will notify the claimant in writing if the claim is deficient. If the deficiency is corrected within 30 days from the time the claimant receives notice, the claim will be considered filed on the date the initial statement of claim was filed with the Director under Rule 12300(a). If all deficiencies are not corrected within 30 days, the Director will close the case without serving the claim, and will refund part of the filing fee in the amount indicated in the schedule under Rule 12900(c).

(c) The panel will not consider any counterclaim, cross claim or third party claim that is deficient. The reasons a counterclaim, cross claim or third party claim may be deficient include the reasons listed in paragraph (a). The Director will notify the party making the counterclaim, cross claim or third party claim of [the] any deficiencies in writing. If the deficiency is corrected within 30 days from the time the party receives notice, the counterclaim, cross claim or third party claim will be considered filed on the date the initial counterclaim, cross claim or third party claim was filed with the Director. If all deficiencies are not corrected within 30 days from the time the party making the counterclaim, cross claim or third party claim receives notice of the deficiency, the panel will proceed with the arbitration as though the deficient counterclaim, cross claim or third party claim had not been made.

## Industry Code

### 13300. Filing and Serving Documents

– (f) No change

(g)(1) In an electronic or paper filing with FINRA, any document that contains an individual’s Social Security number, taxpayer identification number or financial account number must be redacted to include only the last four digits of any of these numbers; a party shall not include the full numbers. If FINRA receives a claim, including supporting documents, with the full Social Security number, taxpayer identification number or financial account number, FINRA will deem the filing deficient under Rule 13307 and will request that the party refile the document in compliance with this paragraph. If a party files with FINRA any document not covered by Rule 13307, that contains full numbers as referenced above, FINRA will deem the filing improper and will request that the party refile the document within 30 days from the time the party receives notice. If a party refiles the document, the corrected documents will be considered filed on the date the party initially filed the documents with FINRA.

(2) The requirements of paragraph (g)(1) above do not apply to electronic or paper documents that parties exchange with each other and do not file with FINRA or to documents parties submit to a panel at a hearing on the merits.

(3) The requirements of paragraphs (g)(1) above do not apply to Simplified Arbitrations under Rule 13800.

### 13307. Deficient Claims

The Director will not serve any claim that is deficient. The reasons a claim may be deficient include the following:

- A Submission Agreement was not filed by each claimant;
- The Submission Agreement was not properly signed and dated;
- The Submission Agreement does not name all parties named in the claim;
- The claimant did not file the correct number of copies of the Submission Agreement, statement of claim or supporting documents for service on respondents and for the arbitrators;
- The claim does not specify the claimant's or the claimant's representative's current address; [or]
- The claimant did not pay all required filing fees, unless the Director deferred the fees; or
- The claim does not comply with the restrictions on filings with personal confidential information under Rule 13300(g).

(b) The Director will notify the claimant in writing if the claim is deficient. If the deficiency is corrected within 30 days from the time the claimant receives notice, the claim will be considered filed on the date the initial statement of claim was filed with the Director under Rule 13300(a). If all deficiencies are not corrected within 30 days, the Director will close the case without serving the claim, and will refund part of the filing fee in the amount indicated in the schedule under Rule 13900(c).

(c) The panel will not consider any counterclaim, cross claim or third party claim that is deficient. The reasons a counterclaim, cross claim or third party claim may be deficient include the reasons listed in paragraph (a). The Director will notify the party making the counterclaim, cross claim or third party claim of [the] any deficiencies in writing. If the deficiency is corrected within 30 days from the time the party receives notice, the counterclaim, cross claim or third party claim will be considered filed on the date the initial counterclaim, cross claim or third party claim was filed with the Director. If all deficiencies are not corrected within 30 days from the time the party making the counterclaim, cross claim or third party claim receives notice of the deficiency, the panel will proceed with the arbitration as though the deficient counterclaim, cross claim or third party claim had not been made.

## Self-Trades

### SEC Approves FINRA Rule Concerning Self-Trades

Effective Date: August 25, 2014

#### Executive Summary

The SEC approved new supplementary material to FINRA Rule 5210 (Publication of Transactions and Quotations) to address transactions in a security resulting from the unintentional interaction of orders originating from the same firm that involve no change in the beneficial ownership of the security (self-trades). Effective August 25, 2014, firms must have policies and procedures in place that are reasonably designed to review trading activity for, and prevent, a pattern or practice of self-trades resulting from orders originating from a single algorithm or trading desk, or related algorithms or trading desks. This *Notice* describes the new rule, including firms' obligations regarding self-trades and under what circumstances algorithms or trading strategies are presumed to be "related" for purposes of the rule.

The new rule text is available in the online FINRA Manual.

Questions concerning this *Notice* should be directed to Brant Brown, Associate General Counsel, Office of General Counsel, at (202) 728-6927 or [brant.brown@finra.org](mailto:brant.brown@finra.org).

#### Background & Discussion

FINRA Rule 5210 provides that "no member shall publish or circulate, or cause to be published or circulated, any...communication of any kind which purports to report any transaction as a purchase or sale of any security unless such member believes that such transaction was a bona fide purchase or sale of such security." On May 1, 2014, the SEC approved new Supplementary Material .02 to Rule 5210.<sup>1</sup> The new supplementary material becomes effective on August 25, 2014, and requires firms to adopt policies and procedures regarding "self-trades," which are defined as "transactions in a security resulting from the unintentional interaction of orders originating from the same firm that involve no change in the beneficial ownership of the security."<sup>2</sup>

#### June 2014

##### Notice Type

- ▶ Guidance
- ▶ New Rule

##### Suggested Routing

- ▶ Compliance
- ▶ Institutional
- ▶ Internal Audit
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Risk
- ▶ Senior Management
- ▶ Systems
- ▶ Trading

##### Key Topics

- ▶ Algorithmic Trading
- ▶ Information Barriers
- ▶ Self-Trades

##### Referenced Rules & Notices

- ▶ FINRA Rule 2010
- ▶ FINRA Rule 5210
- ▶ FINRA Rule 6140
- ▶ NASD Rule 3010
- ▶ Regulatory Notice 14-10

Under Rule 5210 and its supplementary material, self-trades resulting from orders that originate from unrelated algorithms or separate and distinct trading strategies within the same firm would generally be considered bona fide transactions. However, self-trades by a single algorithm or trading desk or related algorithms or trading desks raise heightened concerns that this type of trading may not reflect genuine trading interest, particularly if there is a pattern or practice of such trades. This type of trading becomes increasingly problematic when it accounts for a material percentage of the volume in a particular security.<sup>3</sup> Consequently, under new Supplementary Material .02, firms must have policies and procedures in place that are reasonably designed to review their trading activity for, and prevent, a pattern or practice of self-trades resulting from orders originating from a single algorithm or trading desk, or related algorithms or trading desks. The supplementary material was adopted to address those instances where self-trades, even though unintentional, may not reflect genuine trading interest, especially where they account for a significant amount of volume in a security and potentially adversely affect the price discovery process.

When developing their policies and procedures, firms should note that the supplementary material clarifies that algorithms or trading strategies within the most discrete unit of an effective system of internal controls at a firm are presumed to be “related” for purposes of the rule. As a general matter, FINRA believes that multiple algorithms or trading desks within a discrete unit would be permitted to communicate or would be under the supervision of the same people, and thus will be related; consequently, the supplementary material includes such a presumption. Although the rule establishes this presumption, FINRA recognizes that individual firms may organize their supervisory structure in different ways, and the rule allows for firms to attempt to rebut the presumption. For example, firms could show that effective information barriers exist between the algorithms or desks, that different personnel are responsible for managing or supervising the algorithms or desks, or that the algorithms or desks operate independently from one another in other ways.

## Endnotes

1. Securities Exchange Act Release No. 72067 (May 1, 2014), 79 FR 26293 (May 7, 2014) (Order Approving SR-FINRA-2013-036).
2. Wash sales (*i.e.*, trading involving no change in beneficial ownership that is intended to produce the false appearance of trading) continue to be strictly prohibited under both the federal securities laws and FINRA rules. *See, e.g.*, 15 U.S.C. 78i(a)(1); FINRA Rule 6140(b). In addition, Supplementary Material .02 does not change firms' existing obligations under NASD Rule 3010 and FINRA Rule 2010. The SEC recently approved moving NASD Rule 3010 into the Consolidated FINRA Rulebook as FINRA Rule 3110 with significant changes. *See* Securities Exchange Act Release No. 71179 (December 23, 2013), 78 FR 79542 (December 30, 2013) (Order Approving SR-FINRA-2013-025); *see also* [\*Regulatory Notice 14-10\*](#) (March 2014).
3. The rule does not establish a specific threshold below which a firm could continue to engage in unlimited self-trading. As FINRA noted throughout the rulemaking process, it recognizes that isolated self-trades are generally bona fide transactions; however, self-trading over time, whether of material volume, regularity, or both, would indicate a pattern or practice that firms should review their trading activity for and prevent.

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