

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend NASD IM-2110-2 (Trading Ahead of Customer Limit Order) to clarify the scope of the minimum price improvement obligations.

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change has been approved by the General Counsel of FINRA pursuant to delegated authority. No other action by FINRA is necessary for the filing of the proposed rule change.

FINRA has filed the proposed rule change for immediate effectiveness. The operative date of the proposed rule change will be 30 days after the date of filing.

3. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

In 1994, the SEC approved Interpretive Material (IM) 2110-2 (Trading Ahead of Customer Limit Order), which generally prohibits a member from trading for its own account in a security at a price that is equal to or better than an unexecuted customer limit

¹ 15 U.S.C. 78s(b)(1).

order in that security, unless the member immediately, in the event it trades ahead, executes the customer limit order at the price at which it traded for its own account or better.²

IM-2110-2 also prescribes a minimum level of “price improvement” necessary for a member to execute an order on a proprietary basis when holding an unexecuted limit order. In other words, IM-2110-2 sets forth price-improvement standards that impose a minimum amount by which a firm must trade, in addition to the price of the customer buy limit order (or less than the price of a customer sell order), to not trigger the protections under the rule. This requirement is intended to prevent a practice of firms trading ahead of their customers’ limit orders by trivial amounts and, thereby, circumventing the rule.

The language in IM-2110-2 provides the minimum amount of price improvement necessary for a member to execute an incoming order on a proprietary basis when holding an unexecuted limit order in that same security. Recently, a firm inquired about the scope of the application of the rule due to the term “incoming;” specifically, whether the minimum price improvement standards apply only when a member is trading proprietarily in response to an “incoming” order. FINRA advised the firm that such a narrow application of IM-2110-2 is inconsistent with the fundamental intent of the rule and the purpose of the prescribed minimum price improvement requirements. FINRA has never distinguished the application of the minimum price improvement requirements based on what circumstances prompted the proprietary trade. Therefore, FINRA is amending IM-2110-2 to delete the word “incoming” to make clear that the minimum

² See Securities Exchange Act Release No. 34279 (June 29, 1994), 59 FR 34883 (July 7, 1994) (order approving File No. SR-NASD-93-58).

price improvement requirements apply to any proprietary trading by a member in a security for which the member holds an unexecuted customer limit order, whether or not in response to an incoming order, unless a specific exception applies.

As noted in Item 2 of this filing, FINRA has filed the proposed rule change for immediate effectiveness. The operative date of the proposed rule change will be 30 days after the date of filing.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,³ which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change makes clear the application of the minimum price improvement standards under IM-2110-2, which provide an important safeguard for investors by ensuring that firms do not circumvent the protections provided by the Rule by trading ahead of customer limit orders by economically insignificant amounts.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

³ 15 U.S.C. 78o-3(b)(6).

5. **Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others**

Written comments were neither solicited nor received.

6. **Extension of Time Period for Commission Action**

Not applicable.

7. **Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

The proposed rule change is effective upon filing pursuant to Section 19(b)(3) of the Act⁴ and paragraph (f)(6) of Rule 19b-4 thereunder,⁵ in that the proposed rule change does not significantly affect the protection of investors or the public interest; does not impose any significant burden on competition; and does not become operative for 30 days after filing.

In accordance with Rule 19b-4,⁶ FINRA submitted written notice of its intent to file the proposed rule change, along with a description and text of the proposed rule change, at least five business days prior to the date of filing.

8. **Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission**

Not applicable.

⁴ 15 U.S.C. 78s(b)(3).

⁵ 17 CFR 240.19b-4(f)(6).

⁶ 17 CFR 240.19b-4.

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2009-037)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend NASD IM-2110-2 (Trading Ahead of Customer Limit Order) to Clarify the Scope of the Minimum Price Improvement Obligations

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by FINRA. FINRA has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,³ which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

FINRA is proposing to amend NASD IM-2110-2 (Trading Ahead of Customer Limit Order) to clarify the scope of the minimum price improvement obligations.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

The text of the proposed rule change is available on FINRA's Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

In 1994, the SEC approved Interpretive Material (IM) 2110-2 (Trading Ahead of Customer Limit Order), which generally prohibits a member from trading for its own account in a security at a price that is equal to or better than an unexecuted customer limit order in that security, unless the member immediately, in the event it trades ahead, executes the customer limit order at the price at which it traded for its own account or better.⁴

IM-2110-2 also prescribes a minimum level of "price improvement" necessary for a member to execute an order on a proprietary basis when holding an unexecuted limit order. In other words, IM-2110-2 sets forth price-improvement standards that impose a

⁴ See Securities Exchange Act Release No. 34279 (June 29, 1994), 59 FR 34883 (July 7, 1994) (order approving File No. SR-NASD-93-58).

minimum amount by which a firm must trade, in addition to the price of the customer buy limit order (or less than the price of a customer sell order), to not trigger the protections under the rule. This requirement is intended to prevent a practice of firms trading ahead of their customers' limit orders by trivial amounts and, thereby, circumventing the rule.

The language in IM-2110-2 provides the minimum amount of price improvement necessary for a member to execute an incoming order on a proprietary basis when holding an unexecuted limit order in that same security. Recently, a firm inquired about the scope of the application of the rule due to the term "incoming;" specifically, whether the minimum price improvement standards apply only when a member is trading proprietarily in response to an "incoming" order. FINRA advised the firm that such a narrow application of IM-2110-2 is inconsistent with the fundamental intent of the rule and the purpose of the prescribed minimum price improvement requirements. FINRA has never distinguished the application of the minimum price improvement requirements based on what circumstances prompted the proprietary trade. Therefore, FINRA is amending IM-2110-2 to delete the word "incoming" to make clear that the minimum price improvement requirements apply to any proprietary trading by a member in a security for which the member holds an unexecuted customer limit order, whether or not in response to an incoming order, unless a specific exception applies.

FINRA has filed the proposed rule change for immediate effectiveness. The operative date of the proposed rule change will be 30 days after the date of filing.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁵ which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change makes clear the application of the minimum price improvement standards under IM-2110-2, which provide an important safeguard for investors by ensuring that firms do not circumvent the protections provided by the Rule by trading ahead of customer limit orders by economically insignificant amounts.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed,

⁵ 15 U.S.C. 78o-3(b)(6).

or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act⁶ and Rule 19b-4(f)(6) thereunder.⁷

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2009-037 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2009-037. This file number should be included on the subject line if e-mail is used. To help the Commission process

⁶ 15 U.S.C. 78s(b)(3)(A).

⁷ 17 CFR 240.19b-4(f)(6).

and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2009-037 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁸

Florence E. Harmon
Deputy Secretary

⁸ 17 CFR 200.30-3(a)(12).

EXHIBIT 5

Below is the text of the proposed rule change. Proposed deletions are in brackets.

* * * * *

2000. BUSINESS CONDUCT

2100. GENERAL STANDARDS

* * * * *

IM-2110-2. Trading Ahead of Customer Limit Order

(a) General Application

To continue to ensure investor protection and enhance market quality, NASD's Board of Governors is issuing an interpretation to NASD Rules dealing with member firms' treatment of their customer limit orders in NMS stocks and OTC equity securities. This interpretation, which is applicable from 9:30 a.m. to 6:30 p.m. Eastern Time, will require members to handle their customer limit orders with all due care so that members do not "trade ahead" of those limit orders. Thus, members that handle customer limit orders, whether received from their own customers or from another member, are prohibited from trading at prices equal or superior to that of the limit order without executing the limit order. In the interests of investor protection, NASD is eliminating the so-called disclosure "safe harbor" previously established for members that fully disclosed to their customers the practice of trading ahead of a customer limit order by a market-making firm.¹ For purposes of this interpretation, (1) "NMS stock" shall have the meaning set forth in SEC Rule 600(b)(47) of Regulation NMS and (2) "OTC equity security" shall have the meaning set forth in Rule 6610(d).

Rule 2110 states that:

A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

Rule 2320, the Best Execution Rule, states that:

In any transaction for or with a customer, a member and persons associated with a member shall use reasonable diligence to ascertain the best inter-dealer market for the subject security and buy or sell in such a market so that the resultant price to the customer is as favorable as possible to the customer under prevailing market conditions.

Interpretation

The following interpretation of Rule 2110 has been approved by the Board:

A member firm that accepts and holds an unexecuted limit order from its customer (whether its own customer or a customer of another member) in an NMS stock or OTC equity security and that continues to trade the subject security for its own account at prices that would satisfy the customer's limit order, without executing that limit order, shall be deemed to have acted in a manner inconsistent with just and equitable principles of trade, in violation of Rule 2110, provided that a member firm may negotiate specific terms and conditions applicable to the acceptance of limit orders only with respect to limit orders that are: (a) for customer accounts that meet the definition of an "institutional account" as that term is defined in Rule 3110(c)(4); or (b) 10,000 shares or more, unless such orders are less than \$100,000 in value. In the event that a member trades ahead of an unexecuted customer limit order at a price that is better than the unexecuted limit order, such member is required to execute the limit order at the price received by the member or

better. Nothing in this interpretation, however, requires members to accept limit orders from any customer.

By rescinding the safe harbor position and adopting this interpretation, NASD wishes to emphasize that members may not trade ahead of their customer limit orders even if the member had in the past fully disclosed the practice to its customers prior to accepting limit orders. NASD believes that, pursuant to Rule 2110, members accepting and holding unexecuted customer limit orders owe certain duties to their customers and the customers of other member firms that may not be overcome or cured with disclosure of trading practices that include trading ahead of the customer's order. The terms and conditions under which institutional account or appropriately sized customer limit orders are accepted must be made clear to customers at the time the order is accepted by the firm so that trading ahead in the firm's market-making capacity does not occur.

The minimum amount of price improvement necessary for a member to execute an [incoming]order on a proprietary basis when holding an unexecuted limit order in that same security, and not be required to execute the held limit order is as follows:

- 1) For customer limit orders priced greater than or equal to \$1.00, the minimum amount of price improvement required is \$0.01 for NMS stocks and the lesser of \$0.01 or one-half (1/2) of the current inside spread for OTC equity securities;
- 2) For customer limit orders priced greater than or equal to \$.01 and less than \$1.00, the minimum amount of price improvement required is the lesser of \$0.01 or one-half (1/2) of the current inside spread;

3) For customer limit orders priced less than \$.01 but greater than or equal to \$.0001, the minimum amount of price improvement required is the lesser of \$.0001 or one-half (1/2) of the current inside spread;

4) For customer limit orders priced less than \$.001 but greater than or equal to \$.00001, the minimum amount of price improvement required is the lesser of \$.00001 or one-half (1/2) of the current inside spread;

5) For customer limit orders priced less than \$.0001 but greater than or equal to \$.000001, the minimum amount of price improvement required is the lesser of \$.000001 or one-half (1/2) of the current inside spread;

6) For customer limit orders priced less than \$.00001, the minimum amount of price improvement required is the lesser of \$.000001 or one-half (1/2) of the current inside spread; and

7) For customer limit orders priced outside the best inside market, the minimum amount of price improvement required must either meet the requirements set forth above or the member must trade at a price at or inside the best inside market for the security.

For purposes of determining the minimum price improvement standards for customer limit orders in OTC equity securities priced below \$1.00 where there is no published current inside spread, members may calculate a current inside spread by contacting and obtaining priced quotations from at least two unaffiliated dealers and using the highest bid and lowest offer obtained in calculating the current inside spread. Where there is only a one-sided quote in an OTC equity security priced below \$1.00, members may calculate the current inside spread by contacting and obtaining priced quotations from at least two unaffiliated dealers and using the best price obtained on the

other side of the quote. Members must document the name of each dealer contacted and the quotations received for purposes of determining the current inside spread.

In addition, if the minimum price improvement standards above would trigger the protection of a pending customer limit order, any better-priced customer limit order(s) must also be protected under this IM, even if those better-priced limit orders would not be directly triggered under the minimum price-improvement standards above.

NASD also wishes to emphasize that all members accepting customer limit orders owe those customers duties of "best execution" regardless of whether the orders are executed through the member or sent to another member for execution. As set out above, the Best Execution Rule requires members to use reasonable diligence to ascertain the best inter-dealer market for the security and buy or sell in such a market so that the price to the customer is as favorable as possible under prevailing market conditions. NASD emphasizes that order entry firms should continue to monitor routinely the handling of their customers' limit orders regarding the quality of the execution received.

(b) through (d) No Change.

* * * * *

¹ No Change to Footnote