SIFMA
Securities Industry and
Financial Markets Association

December 18, 2008

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

Re: FINRA Regulatory Notice 08-68

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association[1] ("SIFMA") appreciates the opportunity to comment on Regulatory Notice 08-68. SIFMA agrees that false and misleading rumors have the potential to distort the market and undermine investor confidence, and therefore recognizes the role of FINRA and the other self-regulatory organizations ("SROs") in minimizing the negative effects on investors caused by the circulation of these types of rumors. In its current form, however, FINRA's Proposed Rule 2030 is unworkable as it will hinder rather than advance investor interests. Specifically, the proposal will have the effect of chilling the circulation of legitimate market information and impeding the ability of members to respond to false rumors. In doing so, the proposal will have the unintended adverse effect of increasing the impact of a rumor spread by a person intent on manipulating the market for a security. The proposal also will impose unrealistic reporting obligations on members. We strongly recommend revising the proposed rule to more appropriately tailor its scope and to accurately reflect market realities, including recognizing the need for market participants to discuss rumors in a responsible fashion. As discussed below, such an approach would be consistent with the rules of other SROs and foreign regulators, such as the U.K.'s Financial Services Authority ("FSA").

In formulating a rule on this critical topic, we believe it is essential for FINRA to coordinate with other SROs to ensure a consistent approach. In that regard, we understand

[1] SIFMA brings together the shared interests of more than 650 securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the market and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington, D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. More information about SIFMA is available on its website at www.sifma.org.

that the NYSE Risk Group has been developing proposed language to amend its Rule 435(5) regarding rumors that would, in our opinion, preserve the best elements of the current NYSE rule while making a number of necessary enhancements. Most importantly, the NYSE proposal acknowledges the importance of permitting regulated market participants to engage in responsible discussion of rumors when commenting is necessary to explain market and trading conditions (*e.g.*, unexpected volume), and to allow comment on information that is being widely circulated in the market.

SIFMA supports the approach articulated in the NYSE's proposed amendments, and therefore respectfully requests that FINRA coordinate with the NYSE in formulating a uniform rule for inclusion both in the FINRA rulebook and in the standalone NYSE rulebook. We also ask that such rule proposal be republished for notice and comment by FINRA. Where SIFMA members believe that the NYSE proposal requires further modification and clarification, we have so noted below.

I. FINRA's Rumor Proposal Raises Significant Issues

A. FINRA's Proposal is Overbroad as to Relevant Rumors

FINRA's proposed rule is overbroad in that it would apply to immaterial and true rumors. Prohibiting the discussion of such rumors would serve no regulatory purpose.

FINRA proposed a disjunctive two-prong test for determining when a rumor is subject to the rule – if the rumor is "false or misleading" or if it "would improperly influence the market price of such security." Because the rationale for the rule is to protect investors from conduct that distorts the market, we believe there is no justification or benefit to proscribing rumors that do not "improperly influence the market price" of a security.

The disjunctive, two-prong test also creates a potential category of rumors that are true and yet somehow exert an "improper" influence on the market. We do not believe that there is any benefit to proscribing information that a member has no reasonable grounds to believe is false or misleading. The only type of true information that could be said to "improperly" influence the market is material non-public information, the abuse of which is already covered by the federal securities laws.[2] In short, we believe that the rule should be limited to rumors that are both "false and misleading" and are likely to "improperly influence" the market.

[2] In this regard, SIFMA concurs with the NYSE's proposed interpretive guidance, which explains that knowingly creating or passing false rumors or information with the intent to cause an impact on the price movement of securities is unlawful and is in violation of just and equitable principles of trade, as well as the antifraud and anti-manipulative provisions of the federal securities laws.

B. FINRA's Proposal Inappropriately Limits Legitimate Discussion of Rumors

SIFMA is particularly concerned that FINRA's proposal contains no provision to allow firms to engage in responsible discussion and comment on rumors. Without such an exception, firms will be unable to comment on or respond to legitimate customer inquiries about significant market activity related to widely disseminated rumors or news that may be inaccurate. For example, nothing in the rule would distinguish between rumors and the sort of remarks made on a daily basis by financial commentators in media outlets such as CNBC, Bloomberg, Fox Business News, or widely read on-line media sources or financial blogs such as Seeking Alpha or the Drudge Report. Nor does the rule recognize that certain rumors – even those not widely circulated – may have a significant impact on a particular client or a firm's trading or positions, thus making inquiry or discussion regarding the rumor appropriate and necessary. Indeed, in today's information age, the easy accessibility of rumors via internet or other media with limited viewership renders the "widely circulated" requirement obsolete.

By prohibiting outright the discussion of such a broad range of rumors, the proposed rule fails to recognize that members have legitimate business reasons for discussing rumors—whether widely circulated or not—with customers and other market participants. In particular, the proposed rule would prevent firms from repeating rumors when attempting to verify or debunk a rumor, or when providing advice to their clients about the rumor. For example, a widely circulated rumor recently appeared on a CNN news blog that a major technology company's CEO had suffered a heart attack, resulting in a dramatic and otherwise unexplained drop in the company's stock price.[3] The proposed rule would prohibit a firm from attempting to determine the accuracy of a rumor by discussing the rumor with other market participants, counterparties or companies.

In addition, the proposed rule fails to recognize that members have a legitimate role in advising – in fact, in some instances, *a responsibility* to advise – clients about rumors of which they are aware that may have an effect on the market for a security (*e.g.*, a client is seeking an explanation for an erratic share price movement which could be explained by the rumor – or asks how to react in the face of market movement based on the rumor). For example, suppose a client enters an order in a security before the open and, shortly thereafter, a rumor about the security is widely disseminated in the media and internet. FINRA's proposed rule would prohibit the broker from contacting his customer to alert him to the media reports (or even from responding to an unsolicited question from the client about market conditions related to the security), thereby putting the client at risk for an adverse execution. By prohibiting such appropriate discussions of rumors, the proposed rule will have the opposite of its intended affect; it will allow false information to dominate the market. Ultimately, such an approach harms rather than protects investors.

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[3] *See, e.g.*, David Gaffen, Apple and the Rumor Mill, Wall St. Journal (Oct. 3, 2008).

Other SROs and foreign regulators have recognized that it is neither practical nor desirable to have an absolute prohibition on discussions of unverified facts. NYSE Rule 435(5), CBOE Rule 4.8 and NYSE Arca Rule 6.4 demonstrate the long-standing recognition that firms play a role in discussing rumors in the marketplace. NYSE Rule 435(5) permits the discussion of "unsubstantiated information published by widely circulated public media" "when its source and unsubstantiated nature are also disclosed." CBOE Rule 4.8 and NYSE Arca Rule 6.4 permit the discussion of any "unsubstantiated information, so long as its source and unverified nature are disclosed."

The same understanding exists overseas, where the FSA recently commented that because the "flow of information, when communicated responsibly, is an essential element of efficient markets," "[r]umours are legitimately circulated through the financial system for a variety of reasons." [4] In recognition of its view that "market participants have a role in advising clients of rumours gaining wide circulation in the market,"[5] the FSA permits the discussion of rumors by market participants provided the market participants cite the source of the information (where possible), do not add any credibility to the rumor, and make clear that the information is unverified and a rumor.[6] FINRA's failure to incorporate this basic need to discuss rumors into its proposal makes the rule unworkable.

C. FINRA's Proposal Imposes an Impractical Reporting Requirement

Proposed Rule 2030 would require a member to "promptly report to FINRA any circumstance which reasonably would lead the member to believe that any such rumor might have been originated or circulated." Given the breadth of rumors covered by the proposed rule (as discussed above), the proposed reporting requirement as drafted is wholly impractical. It would require the reporting of numerous rumors on a daily basis. For example, as drafted, the proposed rule would require members to report speculative information reported in the Wall Street Journal, on CNBC, or any of the many rumors alleged in financial blogs or online chatrooms. Adding to the burden of the reporting requirement is the fact that FINRA's proposal – unlike its NYSE and NASD antecedents – applies to rumors "concerning any security" and not just exchange-listed securities or those reported on the Consolidated Tape.[7] Indeed, as discussed below, proposed NYSE revisions to Rule 435(5) implicitly recognize the impracticality of the reporting requirement by striking that provision from the proposed rule.

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[4] FSA, Market Watch, Market Division: Newsletter on Market Conduct and Transaction Reporting Issues, Issue No. 30 (Nov. 2008) at 4 ("FSA Newsletter").

[5] *Id*. at 4.

[6] *Id*. at 4. Moreover, the FSA recognizes the value of appropriate training about the rumors. *Id*. at 4-6.

[7] Although it does not support the proposed reporting requirement, SIFMA supports the broadening of the types of securities subject to the proposed rule, provided the rule is amended to take into account the comments described herein.

Even with a reformulated rule that appropriately balances the need to prevent the manipulative dissemination of rumors with the importance of allowing responsible discussion of rumors, the reporting requirement will continue to be overly burdensome and unworkable in practice. Moreover, an appropriately drafted rule will make the reporting of rumors unnecessary, as it will provide market participants with the necessary tools to verify the veracity of rumors responsibly in real-time to the benefit of the markets. As a result, we believe that the reporting requirement should be eliminated from the final rule.

II. SIFMA Generally Supports the NYSE Proposal

The NYSE Risk Group has drafted proposed revisions to its rumor rule, Rule 435(5). The NYSE's proposal addresses many of the concerns SIFMA has about the FINRA proposal. We urge FINRA to revise its proposal to reflect the approach taken by the NYSE, subject to additional modifications and clarifications discussed in the next section.

- Unlike the FINRA proposal, the NYSE would not apply its rumor rule to immaterial or true rumors. Specifically, the NYSE only prohibits the circulation of "rumors of a sensational character." "Sensational character" is defined as "any information that is believed to be an exaggeration of the truth, false or misleading, and is reasonably likely to be considered material to the value of one or more classes of securities of an issuer." "Material" is defined as information that would be "significant to a reasonable investor in making a decision whether to hold, purchase or sell a security."

- Moreover, NYSE's proposal permits the responsible discussion of widely circulated rumors. It states that "[d]iscussion of unsubstantiated information published by widely circulated public media is not prohibited when its source and unsubstantiated nature are also disclosed."[8]

- SIFMA also approves of the NYSE's recognition of the need for firms to engage in the responsible discussion of rumors to explain market or trading conditions. Specifically, it is our understanding that the NYSE proposed interpretive materials clarify that the rule does not prohibit repeating of rumors to market participants when commenting is necessary in order to explain market or trading conditions and, in that context, it may be appropriate to comment and present one's view of the validity of the information in a responsible way.

[8] While identifying a particular media source generally is helpful, situations may arise where, in order to preserve confidences and encourage member firms to seek to verify rumors, members may wish to describe the source more generally by category (*e.g.*, "buy-side firm," "various broker-dealers"). Thus, the rule or interpretive material should clarify that members need not identify their source by name when providing the source of a covered rumor.

- SIFMA fully supports the NYSE's decision to delete its existing rumor reporting requirement. This revision removes an impractical and overly broad reporting requirement.

- Finally, in its proposal, the NYSE intends to introduce an explicit requirement for adequate written policies and supervisory procedures reasonably designed to identify and address the circulation of rumors. SIFMA agrees that firms should have in place written policies and procedures that set forth their approach to addressing the inappropriate circulation of rumors, including under what circumstances rumors can be circulated. SIFMA also agrees that firms should provide regular training on these policies and procedures as well as provide supplemental, specific guidance when sought by registered personnel.

III. SIFMA Proposes Limited Modifications to NYSE Proposal

Although SIFMA believes that the NYSE proposal generally addresses many of its concerns with regard to FINRA's approach, SIFMA respectfully suggests that, in formulating the final rule, due consideration be given to the following modifications, which SIFMA believes would further enhance the efficacy of the proposed rule without diminishing its goals.

- The proposed rule (or an interpretation thereof) should clearly state that it does not apply to internal discussions about rumors. Such intra-firm discussions are critical, not only to investigating rumors, but also to ensuring that rumors are treated by the firm and its representatives in compliance with regulatory guidance and in the best manner possible for its clients.

- Expressions of opinion, such as those by research analysts (as defined in NASD Rule 2711) in reports and other market color, should be excluded from the definition of rumor.[9] In that regard, we agree with the FSA's statement that a rumor is unlikely to include statements that are "clearly the expression of an individual's or a firm's opinion, such as an analyst's view of the prospects of a company."[10]

- The rule should permit responsible discussion of not only widely circulated rumors, but all rumors, as the CBOE and NYSE Arca currently allow, provided

[9] We note that research analysts and their research reports are subject to substantial oversight that is tailored to such activity, including customized restrictions on compensation and personal trading, as well as affirmative disclosure requirements. NASD Rule 2711. SIFMA believes that these requirements adequately address any concerns about the circulation of an analyst's opinion.

[10] FSA Newsletter at 1.

the unverified nature of the rumor is communicated.[11] In that regard, we suggest that the rule clarify that it would not prohibit members from repeating such information, whether widely circulated or not, when commenting is reasonably believed to be necessary in order to explain market or trading conditions provided the unsubstantiated nature of the rumor is disclosed. Notably, the "reasonably believed to be" concept is important because it would provide an exception for those situations where a firm believed comment was necessary based on information available to it at the time, even if it turned out to be unnecessary.

- It is our understanding that the NYSE's proposed interpretive material states that "[i]n that context, and with due regard that no representative would be acting in a way intended to influence price movement by repeating the information, it is appropriate to comment and present one's view of the validity of such information in a responsible way." We would alter the NYSE's proposed proviso by stating that a representative's comment on a rumor must not be intended to "manipulate price movement" in a security, rather than merely "influence price movement." The standard of intent to "influence price movement" is too vague and fails to capture the underlying regulatory concern regarding intentional price manipulation. For example, when a firm informs its clients that a rumor is false, it may have the appropriate effect of influencing price movement. In contrast, the term "manipulate," not only captures the primary regulatory concern, but it also is a term that is known and well-understood in the industry.[12]

IV. FINRA Should Ensure Its Approach is Consistent with the NYSE's Approach

We believe that it is imperative for FINRA to coordinate its approach with the NYSE, so as to avoid conflicting regulatory requirements with regard to rumors. Specifically, we believe that the best way forward is for FINRA to adopt the NYSE proposal as its working draft and to coordinate with the NYSE in finalizing its language for inclusion both in the FINRA rulebook and in the standalone NYSE rulebook. In working toward the final rule language, we urge FINRA to enhance the NYSE proposal in the manner described in the previous section. Indeed, such coordination should be part of FINRA's greater efforts to streamline its rulebooks generally.

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[11] Such an approach would avoid the often difficult determinations regarding whether various means of dissemination would meet the definition of "widely circulated public media." For example, firms currently struggle with the question of whether expensive subscription news sources would be considered "widely circulated public media."

[12] *See*, *e.g.*, Exchange Act Rel. No. 58166 (July 15, 2008) (discussing various regulatory actions taken to address illegal market manipulation through the dissemination of false rumors); SEC Press Release 1008-140 (July 13, 2008) (announcing it would conduct exams aimed at preventing the intentional spreading of false information intended to manipulate securities prices); SEC Litigation Rel. No. 20537 (Apr. 24, 2008) (SEC charges trader with market manipulation for intentionally disseminating a false rumor).

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We appreciate the opportunity to provide comment on FINRA's rule proposal. SIFMA would be pleased to discuss any comments herein, or provide FINRA with any additional assistance as it proceeds with the rule proposal. Please do not hesitate to contact me at (212) 313-1268 if you have any questions or comments.

Sincerely,

Amal Aly
Managing Director and
Associate General Counsel

cc: Mary L. Schapiro, Chief Executive Officer, FINRA
Stephen Luparello, Senior Executive Vice President, Regulatory, FINRA
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