

Regulatory Notice

08-68

Circulation of Rumors

FINRA Requests Comment on Proposed FINRA Rule Addressing the Circulation of Rumors

Comment Period Expires: December 18, 2008

Executive Summary

As part of the process of developing a new, consolidated rulebook (the Consolidated FINRA Rulebook), FINRA is requesting comment on a proposed FINRA Rule relating to the circulation of rumors. The proposed rule is based on FINRA Rule 6140 and Incorporated NYSE Rule 435(5).¹

Questions concerning this *Notice* should be directed to Brant Brown, Associate General Counsel, Office of General Counsel, at (202) 728-6927.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by December 18, 2008.

Member firms and other interested parties can submit their comments using 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

November 2008

Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

Suggested Routing

- Compliance
- Legal
- Registered Representatives
- Senior Management

Key Topic(s)

- Circulation of Rumors

Referenced Rules & Notices

- FINRA Rule 6140
- NASD Rule 5120
- Incorporated NYSE Rule 435(5)

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

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.²

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.³

Background & Discussion

Proposal

FINRA is proposing Rule 2030, a new, stand-alone rule, that combines aspects of Incorporated NYSE Rule 435(5) and FINRA Rule 6140(e) and that extends the prohibition on the origination or circulation of rumors to cover all securities.⁴ FINRA is proposing to replace Rule 6140(e) and Incorporated NYSE Rule 435(5), as well as the Interpretation to Incorporated NYSE Rule 435(5), with the following:

Rule 2030. Circulation of Rumors

No member shall originate or circulate in any manner a rumor concerning any security which the member knows or has reasonable grounds for believing is false or misleading or would improperly influence the market price of such security. A member must promptly report to FINRA any circumstance which reasonably would lead the member to believe that any such rumor might have been originated or circulated.

The proposed rule includes standards and obligations derived from both existing rules. Aspects of the proposed rule are described more fully below.

- **Use of the term “rumor.”** As noted above, although Rule 6140(e) does not use the term “rumor,” Incorporated NYSE Rule 435(5) specifically refers to the circulation of “rumors.” FINRA is proposing to adopt this term into Rule 2030 without the qualification in Incorporated NYSE Rule 435(5) that the rumor be “of a sensational character” and “reasonably be expected to affect market conditions on the Exchange.” Instead, FINRA is proposing to maintain the standard in Rule 6140 that the member know or have reasonable grounds for believing that the rumor is “false or misleading or would improperly influence the market price of such security.”

- **Scope of the proposed rule.** FINRA is proposing that Rule 2030 apply to all securities, not just those securities reported to the Consolidated Tape. The genesis of Rule 6140 was related to the creation and maintenance of the integrity of the information on the Consolidated Tape, but the conduct addressed in the rule was also subject to the antifraud and antimanipulation provisions of the federal securities laws.⁵ It is FINRA's view that the origination and circulation of rumors present the same risks to the integrity of the market regardless of whether the security is listed on a national securities exchange or trades solely over the counter. Consequently, FINRA is proposing that Rule 2030 apply to all securities.
- **Reporting requirement.** FINRA is proposing that Rule 2030 include a reporting requirement similar to the reporting requirement in Incorporated NYSE Rule 435(5). The proposed reporting requirement would require firms to report promptly to FINRA any circumstance which reasonably would lead the firm to believe that any rumor covered by the rule might have been originated or circulated. Incorporated NYSE Rule 435(5) includes a reporting provision with respect to securities traded on the NYSE; Rule 6140(e) does not have a reporting provision. FINRA is proposing to include a reporting provision in the new rule; in keeping with Rule 2030's broader reach to all securities, the reporting requirement would similarly be extended to cover all securities.
- **Unsubstantiated information published by a widely circulated public media.** Incorporated NYSE Rule 435(5) includes an exception from the rule for discussions of "unsubstantiated information published by a widely circulated public media" provided that the source of the information and its unsubstantiated nature are disclosed. Rule 6140(e) does not include this exception. FINRA is not proposing to include the exception in Rule 2030. It is not clear that widely circulated rumors in the public media, that would otherwise be covered by the rule, are of less concern in terms of the market integrity concerns related to such rumors.

Request for Comment

In connection with the proposal, FINRA is requesting comment on certain aspects of proposed Rule 2030. Specifically, FINRA is requesting comment on the following:

- As noted above, FINRA is proposing that Rule 2030 retain the standard in Rule 6140(e) that a rumor not be originated or circulated if the member knows or has reasonable grounds for believing that the rumor is "false or misleading or would improperly influence the market price of such security." Should FINRA continue to use this standard in applying the rule? If not, what standard is appropriate? Should Rule 2030 include the requirement that the rumor be "of a sensational character," as is currently required under Incorporated NYSE Rule 435(5)?

- Does the proposed text of Rule 2030 strike the right balance between the existing rule text in Rule 6140(e) and Incorporated NYSE Rule 435(5)? Are there provisions in either rule that FINRA is proposing to retain that should be removed or revised? Should Rule 2030 include an exception for unsubstantiated information published by a widely circulated public media provided that the source of the information and its unsubstantiated nature are disclosed? Are there other provisions in either rule that FINRA is proposing to delete that should be retained?
- Should Rule 2030 provide greater emphasis on firms' policies and procedures regarding the circulation of rumors? If so, how specific should any such provisions be? What should be required?

In addition to the specific questions listed above, FINRA is also interested in any other issues that commenters may wish to address relating to the proposal.

Endnotes

- 1 The current FINRA rulebook includes, (1) NASD Rules; and (2) rules incorporated from NYSE (Incorporated NYSE Rules). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The new FINRA Rules will apply to all member firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see *FINRA Information Notice 03/12/08* (Rulebook Consolidation Process).
- 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 *NASD Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
- 3 Section 19 of the Securities Exchange Act of 1934 (Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See Exchange Act Section 19 and rules thereunder.
- 4 The SEC recently approved the adoption of NASD Rule 5120 as FINRA Rule 6140, without substantive change, effective December 15, 2008. See *Regulatory Notice 08-57* (October 2008). Although NASD Rule 5120 remains in effect until December 15, 2008, references in this *Notice* are to new FINRA Rule 6140.
- 5 See *NASD Notice to Members 75-42* (June 10, 1975); *NASD Notice to Members 74-52* (December 20, 1974).

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