Regulatory Notice 09-56

Regulatory Pricing Proposal

Proposed Changes to the Personnel Assessment and Gross Income Assessment Fees

Effective Date: Upon SEC Approval With an Implementation Date of January 1, 2010.

Executive Summary

On August 20, 2009, FINRA filed with the SEC a proposal to change FINRA's regulatory pricing structure by restructuring the Personnel Assessment and Gross Income Assessment fees in order to stabilize revenues used to fund FINRA's regulatory activities.[1] If approved, the pricing changes would take effect on January 1, 2010. The SEC has published the proposal for comment. FINRA encourages firms to send comments to the SEC by the October 2, 2009, deadline.

Questions concerning this *Notice* should be directed to:

- Finance at (240) 386-5397; or
- the Office of General Counsel at (202) 728-8071.

Background and Discussion

FINRA's primary pricing structure consists of the following fees: the Personnel Assessment (PA), the Gross Income Assessment (GIA), the Trading Activity Fee and the Branch Office Assessment. These fees are used to fund FINRA's regulatory activities, including its examination and enforcement programs.

September 2009

Notice Type

- Proposed Rule Amendments

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management

Key Topic(s)

- Regulatory Fees
- Gross Income Assessment
- Personnel Assessment

Referenced Rules & Notices

- Regulatory Notice 08-07
- Sections 1 and 2 of Schedule A of the By-Laws

Financial Industry Regulatory Authority

FINRA has filed with the SEC a proposed rule change that would restructure the PA and GIA to achieve a more consistent and predictable funding stream to ensure FINRA can carry out its regulatory mandate. The economic and industry downturns experienced in 2008 and 2009 have strained FINRA's financial resources, yet its regulatory responsibilities remain constant, if not increased, and its programs robust. While FINRA management already has implemented a comprehensive cost-reduction plan and will continue to seek cost savings that do not in any way compromise its regulatory mission, FINRA believes the proposed rule change is needed to stabilize its revenues and provide protection against future industry downturns.

The GIA remains the most important component of FINRA's regulatory funding. The GIA currently is assessed through a seven-tiered rate structure with a minimum GIA of $1,200. Under the current GIA, firms are required to pay an annual GIA as follows:

(1) $1,200 on annual gross revenue up to $1 million;

(2) 0.1215% of annual gross revenue greater than $1 million up to $25 million;

(3) 0.2599% of annual gross revenue greater than $25 million up to $50 million;

(4) 0.0518% of annual gross revenue greater than $50 million up to $100 million;

(5) 0.0365% of annual gross revenue greater than $100 million up to $5 billion;

(6) 0.0397% of annual gross revenue greater than $5 billion up to $25 billion; and,

(7) 0.0855% of annual gross revenue greater than $25 billion.

For 2010, the current year GIA would remain subject to the cap set forth in *Regulatory Notice 08-07* (February 2008), which describes the new funding structure that resulted from the consolidation of NASD's and the New York Stock Exchange's member regulation operations. FINRA states in the *Notice* that it will apply a 10-percent cap on any increase or decrease to a firm's 2010 current year GIA resulting from the new pricing structure implemented in January 2008.

Since the GIA is assessed based on a firm's annual gross revenue for the preceding calendar year,[2] FINRA's revenues derived from the GIA are subject to the year-to-year volatility of firms' revenues. In years where industry revenues are significantly down, FINRA's operating revenues can drop precipitously: in 2009, for example, GIA revenues are down approximately 37 percent due to 2008 fourth quarter write-offs taken by firms, particularly the largest ones. In 2009, FINRA absorbed a $100 million revenue shortfall from the GIA. While this did not hinder FINRA's ability to fulfill its regulatory mission, this type of revenue loss cannot be sustained in the future.

The proposed rule change seeks to ameliorate this vulnerability by smoothing out the volatility inherent in the GIA as well as by shifting some of FINRA's revenue generation to the more consistent PA revenue stream. For the GIA, the proposed rule change would further amend Schedule A to assess a GIA of the greater of (1) the amount that would be the GIA based on the existing rate structure (current year GIA) or (2) a three-year average of the GIA to be calculated by adding the current-year GIA plus the GIA assessed on the firm over the previous two calendar years, divided by three. For a newer firm that has only been assessed in the prior year, FINRA would compare the current year GIA to the two-year average and assess the greater amount. The existing GIA rate structure and phase-in implementation through 2010 would remain the same.[3] Accordingly, the proposed rule change would preserve the current rate structure, while building a buffer against industry downturns. FINRA notes that it has a history of providing rebates to firms when revenues exceed the expenditures necessary to discharge its regulatory obligations and is committed to continuing that practice in the future.

The proposed rule change also shifts revenues previously generated from the GIA to the PA, which is a more stable revenue base. The PA is currently assessed on a three-tiered rate structure: firms with one to five registered representatives and principals are assessed $75 for each such registered person; 6 to 25 registered persons, $70 each; and 26 or more registered persons, $65 each. The proposed rule change would increase those rates to $150, $140 and $130, respectively, based on the same tiered structure. This proposal represents the first PA rate increase in more than five years. Moreover, given the correlation between the cost of FINRA's regulatory programs and the number of registered persons within a firm, FINRA notes that the population of registered persons has remained fairly stable, even throughout the recent economic downturn.[4] Accordingly, FINRA believes an increase of the PA is both a fair and appropriate means to achieve a more consistent and reliable foundation to fund its regulatory operations.

FINRA believes the proposed rule change will stabilize its operating cash flows by augmenting revenues based on the registered person population, where FINRA's costs are more closely aligned, and reducing dependency on, and exposure to, less predictable industry revenues. In aggregate, the fee proposal would result in regulatory fees comparable to those realized in 2008. FINRA estimates that if the proposed rule change had been in effect for 2009, it would have replaced about 90 percent of the revenue shortfall that resulted primarily from the significant drop in GIA receipts. In general, those replacement revenues would come from several larger firms whose steep income declines in 2008 primarily account for FINRA's current revenue deficit.

SEC Request for Comment

The SEC requests comment on the regulatory pricing proposal. The comment period expires **October 2, 2009**. The rule proposal will be implemented upon SEC approval with an effective date of **January 1, 2010.**

Endnotes

1 Exchange Act Release No. 60624 (September 3, 2009), 74 FR 46828 (September 11, 2009) (Notice of Filing of SR-FINRA-2009-057).

2 Gross revenue for assessment purposes is set out in Section 2 of Schedule A, which defines gross revenue as total income as reported on FOCUS form Part II or IIA excluding commodities income.

3 In addition, the proposed rule change would remain subject to the caps on increases and decreases to GIA set forth in *Regulatory Notice 08-07* (February 2008). The actual amount of GIA assessed in any given year—*e.g.*, the capped amount or the three-year average—will be used to calculate subsequent three-year average determinations. The caps, if applicable, would be applied to the current-year assessment and the resulting number would be used to calculate the three-year average.

4 For example, FINRA records show that since 2000, the average number of registered persons per year has been approximately 667,680 and that for each of the past three years the population has been 669,626 (2009), 676,927 (2008) and 662,742 (2007) (based on numbers at the end of the preceding calendar year).

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