

Regulatory Notice

11-43

Indications of Interest

FINRA Requests Comment on Proposed Amendments to Rule 5210 Regarding Publication of Indications of Interest

Comment Period Expires: October 21, 2011

Executive Summary

FINRA requests comment on proposed amendments to FINRA Rule 5210 to require that member firms receive a customer order in a security before displaying a quotation or indication of interest (IOI) in a way that purports to represent that the quotation or IOI originated with a customer. Similarly, a firm could not continue to display a quotation or IOI as representing a customer order once the customer order was executed or cancelled.

The text of the proposed amendments is in Attachment A to this *Notice*.

Questions concerning this *Notice* should be directed to Brant K. 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 October 21, 2011.

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

September 2011

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Institutional
- ▶ Legal
- ▶ Registered Representatives
- ▶ Senior Management
- ▶ Trading

Key Topics

- ▶ Indications of Interest

Referenced Rules & Notices

- ▶ FINRA Rule 2010
- ▶ FINRA Rule 2020
- ▶ FINRA Rule 5210
- ▶ NASD Rule 2210
- ▶ NTM 06-50
- ▶ Regulatory Notice 09-28



Financial Industry Regulatory Authority

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.¹

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).²

Background & Discussion

Indications of interest, or IOIs, are non-firm expressions of trading interest that contain one or more of the following elements: security name, side, size, capacity and/or price. Firms have the ability to communicate or advertise proprietary or customer trading interest in the form of IOIs to the marketplace through their own systems or several service providers that disseminate the information to subscribers and/or the marketplace. For example, some service providers allow firms to publicize trading interest in a particular security relating to firm proprietary interest or interest that the firm represents on an agency basis. A firm may choose to disseminate IOIs to inform other market participants that it seeks to, or represents customer trading interest that seeks to, interact with other order flow in the security.

One attribute that is often associated with an IOI is whether the IOI originated with a customer (what is commonly referred to as a “natural” IOI), rather than with the firm. Although the meaning of the term “natural” may differ across firms and service providers, a “natural” IOI is generally considered to refer either to customer interest a firm represents on an agency basis or to proprietary interest that was established to facilitate a customer order or as part of an execution of a customer order on a riskless principal basis.

In May 2009, FINRA published [*Regulatory Notice 09-28*](#) reminding firms that, to the extent that they disseminate or use services to communicate indications of interest, IOIs must be truthful, accurate and not misleading.³ The *Notice* stated that FINRA could view as untruthful, inaccurate or misleading a firm’s representation of firm proprietary interest as a “natural” IOI without making disclosure to its customers of the circumstances in which such representations are made, or that is inconsistent with disclosures made by a firm with respect to the content of its IOIs, or alternatively through the service provider’s system in a manner contrary to the service provider’s guidelines. FINRA also could view as untruthful, inaccurate or misleading a firm’s continuing dissemination of a “natural” IOI to the marketplace when the firm no longer represents any such interest on behalf of a customer. The *Notice* also stated that the communication of untruthful, inaccurate or

misleading information relating to IOIs would be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade under FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) and, depending on the nature and content of the communication, could also violate FINRA Rule 5210 (Publication of Transactions and Quotations), FINRA Rule 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices), NASD Rule 2210 (Communications with the Public) and the anti-fraud provisions of the federal securities laws.

Request for Comment

Notwithstanding the publication of [Regulatory Notice 09-28](#), FINRA remains concerned that firms are disseminating misleading information regarding IOIs, including not accurately labeling them to reflect their origination. Consequently, FINRA is proposing to amend Rule 5210 in several ways.

First, FINRA is proposing new Supplementary Material to FINRA Rule 5210 that would require that a firm have received a customer order in a security before displaying a quotation or IOI in any way that purports to represent that the quotation or IOI originated with a customer (e.g., by labeling an IOI as “natural”). Thus, firms would not be permitted to label an IOI or quotation in any way that indicates the IOI or quotation represented customer interest until the firm had received a customer order and had recorded the order on its books and records by, for example, creating an order ticket or entering the terms of the order into the firm’s order management system. Importantly, the proposed amendment does not prohibit firms from displaying IOIs or quotations when they have not received a customer order; it merely prohibits the firm from labeling any such IOI or quotation in a way that indicates that the interest arose with a customer. Similarly, a firm could not continue to display such a quotation or IOI as representing a customer order once the customer order was executed or cancelled.

FINRA is also proposing several amendments to Rule 5210 and the existing Supplementary Material to modernize the language in the rule and to align the rule text with the Supplementary Material. Among other things, these amendments would clarify that the prohibitions in Rule 5210 extend to IOIs.

Although FINRA welcomes comments on any aspect of the proposed amendments discussed in this *Notice*, FINRA specifically encourages comments on the following:

- ▶ Should FINRA define the term “indication of interest”? Does the application of the new labeling requirements to both IOIs and quotations adequately cover the situations in which concerns regarding inaccurate labeling arise?
- ▶ Is the approach taken in the proposed amendments appropriate or should FINRA define terms such as “natural” in the rule? Would specific definitions provide firms with clarity or would they create too narrow an application? Would definitions need regular updating to stay current with industry practice?

- ▶ Is the requirement that a firm has received a customer order before labeling an IOI or quotation in a manner that indicates the interest originated with a customer too limiting? Are there instances in which a customer would not want to place an order with a firm, but would want the firm to label an IOI in that manner? Is there an alternative standard that could achieve the same regulatory purpose? If so, what should that standard be?
- ▶ Some buy-side firms have stated that they prefer not to trade with “non-naturals” because “non-naturals” compete with them after the execution. For example, a buy-side firm selling part of a large block to a counterparty may be concerned that the counterparty might create downward pressure on the stock either if it were to sell the position, or if it already sold shares in anticipation of buying from the buy-side firm. Conversely, when trading with a “natural,” the buy-side firm’s selling pressure is potentially offset by the buying interest of the “natural” counterparty. Are these valid concerns by the buy side? Is it too restrictive to assume that “natural” interest can only come from customer orders?

The comment period expires on October 21, 2011.

Endnotes

1. 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 [NTM 03-73](#) (November 2003) (NASD Announces Online Availability of Comments) for more information.
2. See SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
3. The *Notice* also reminded firms that directly disseminate or use services to disseminate IOIs that they must establish, maintain and enforce written supervisory procedures and supervisory systems that are reasonably designed to ensure, among other things, that the information disseminated by or on behalf of the member or its associated persons is truthful, accurate and not misleading. In addition, advertising a firm’s trading activity or interest in contexts other than indications of interest is also subject to FINRA rules and the anti-fraud provisions of the federal securities laws. See [NTM 06-50](#) (September 2006).

ATTACHMENT A

Below is the text of the proposed amendments to Rule 5210. Additional language is underlined; deletions are in brackets.

5210. Publication of Transaction[s] Reports, [and] Quotations, and Indications of Interest

No member shall publish or circulate, or cause to be published or circulated; [, any notice, circular, advertisement, newspaper article, investment service, or communication of any kind which purports to]

(a) any report of any securities transaction as a purchase or sale of [any] such security unless [such] the member believes that such transaction was a bona fide purchase or sale of such security; [or which purports to]

(b) any quotation [quote the bid price or asked price] for any security, unless [such] the member believes that such quotation represents a bona fide bid for, or offer of, such security; or

(c) any indication of interest for any security, unless the member believes that such indication of interest represents a bona fide interest in purchasing or selling such security.

• • • Supplementary Material: -----

.01 Manipulative and Deceptive Transaction Reports, Quotations, and Indications of Interest.

(a) It shall be deemed inconsistent with Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices) and 5210 (Publication of Transactions and Quotations) for a member to publish or circulate or cause to be published or circulated, by any means whatsoever, any report of any securities transaction or of any purchase or sale of any security unless such member knows or has reason to believe that such transaction was a bona fide transaction, purchase, or sale.

(b) [Similarly, i]It shall be deemed inconsistent with Rules 2010, 2020, and 5210 for a member, for itself or for any other person, to publish or circulate or to cause to be published or circulated, by any means whatsoever, any quotation for any security without having reasonable cause to believe that such quotation is a bona fide quotation, is not fictitious, and is not published or circulated or caused to be published or circulated for any fraudulent, deceptive, or manipulative purpose.

[For the purposes of this Rule, the term “quotation” shall include any bid or offer or any formula, such as “bid wanted” or “offer wanted,” designed to induce any person to make or submit any bid or offer.]

(c) It shall be deemed inconsistent with Rules 2010, 2020, and 5210 for a member, for itself or for any other person, to publish or circulate or to cause to be published or circulated, by any means whatsoever, any indication of interest for any security without having reasonable cause to believe that such indication of interest represents a bona fide interest in purchasing or selling the security, is not fictitious, and is not published or circulated or caused to be published or circulated for any fraudulent, deceptive, or manipulative purpose.

(d) With respect to any quotation or indication of interest that purports to represent that the interest the member is displaying originated with a customer, the member must have received a customer order in the security before displaying such quotation or indication of interest. Similarly, the member must withdraw the quotation or indication of interest if the customer order represented by such quotation or indication of interest is executed or cancelled.