3. Track reasons for entering a Limit State, such as:
a. Liquidity gap –price reverts from a Limit State Quotation and returns to trading within the Price Bands
b. Broken trades
c. Primary Listing Exchange manually declares a Trading Pause pursuant to Section (VII)(2) of the Plan
d. Other

B. Determine (1), (2) and (3) for when a Trading Pause has been declared for an NMS Stock pursuant to the Plan.

II. Raw Data (all Participants, except A–E, which are for the Primary Listing Exchanges only)

A. Record of every Straddle State.
1. Ticker, date, time entered, time exited, flag for ending with Limit State, flag for ending with manual override.
2. Pipe delimited with field names as first record.

B. Record of every Price Band
1. Ticker, date, time at beginning of Price Band, Upper Price Band, Lower Price Band
2. Pipe delimited with field names as first record

C. Record of every Limit State
1. Ticker, date, time entered, time exited, flag for halt
2. Pipe delimited with field names as first record

D. Record of every Trading Pause or halt
1. Ticker, date, time entered, time exited, type of halt (i.e., regulatory halt, non-regulatory halt, Trading Pause pursuant to the Plan, other)
2. Pipe delimited with field names as first record

E. Data set or orders entered into reopening auctions during halts or Trading Pauses
1. Arrivals, Changes, Cancels, # shares, limit/market, side, Limit State side
2. Pipe delimited with field name as first record

F. Data set of order events received during Limit States

G. Summary data on order flow of arrivals and cancellations for each 15-second period for discrete time periods and sample stocks to be determined by the SEC in subsequent data requests. Must indicate side(s) of Limit State.
1. Market/marketable sell orders arrivals and executions
a. Count
b. Shares
c. Shares executed
2. Market/marketable buy orders arrivals and executions
a. Count
b. Shares
c. Shares executed
3. Count arriving, volume arriving and shares executing in limit sell orders above NBBO mid-point
4. Count arriving, volume arriving and shares executing in limit sell orders=NBBO mid-point (non-marketable)
5. Count arriving, volume arriving and shares executing in limit buy orders above NBBO mid-point (non-marketable)
6. Count arriving, volume arriving and shares executing in limit buy orders below NBBO mid-point
7. Count and volume arriving of limit sell orders priced at or above NBBO+$0.05
8. Count and volume arriving of limit buy orders priced at or below NBBO – $0.05
9. Count and volume of (iii-viii) for cancels
10. Include: Ticker, date, time at start, time of Limit State, data item fields, last sale prior to 1-minute period (null if no trades today), range during 15-second period, last trade during 15-second period

III. At Least Two Months Prior to the End of the Pilot Period, All Participants Shall Provide to the SEC Assessments Relating to Impact of the Plan and Calibration of the Percentage Parameters as Follows:

A. Assess the statistical and economic impact on limit order book of approaching Price Bands.

B. Assess the statistical and economic impact of the Price Bands on erroneous trades.

C. Assess the statistical and economic impact of the appropriateness of the Percentage Parameters used for the Price Bands.

D. Assess whether the Limit State is the appropriate length to allow for liquidity replenishment when a Limit State is reached because of a temporary liquidity gap.

E. Evaluate concerns from the options markets regarding the statistical and economic impact of Limit States on liquidity and market quality in the options markets. (Participants that operate options exchange should also prepare such assessment reports.)

F. Assess whether the process for entering a Limit State should be adjusted and whether Straddle States are problematic.

G. Assess whether the process for exiting a Limit State should be adjusted.

H. Assess whether the Trading Pauses are too long or short and whether the reopening procedures should be adjusted.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–67079; File No. SR–FINRA–2012–025]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change To Adopt FINRA Rule 5270 (Front Running of Block Transactions) in the Consolidated FINRA Rulebook

May 30, 2012.

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 May 17, 2012, 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, II and III below, which Items have been prepared by FINRA. 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 adopt NASD Interpretive Material (''IM'') 2110–3 (Front Running Policy) as FINRA Rule 5270 with the changes described below.

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

As part of the process of developing a new consolidated rulebook (''Consolidated FINRA Rulebook''),[3] FINRA is proposing to adopt NASD IM–2110–3 (''Front Running Policy'') as FINRA Rule 5270 with the changes described below.

The Front Running Policy, which was adopted as interpretive material to

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (''Incorporated NYSE Rules'') (together, the NASD Rules and Incorporated NYSE Rules are referred to as the ''Transitional Rulebook''). 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 FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, *see Information Notice,* March 12, 2008 (Rulebook Consolidation Process).

Article III, Section 1 of the NASD's Rules of Fair Practice [4] in 1987,[5] states that it is considered conduct inconsistent with just and equitable principles of trade for a member or an associated person of a member to buy or sell security futures or certain options for accounts in which the member or associated person has an interest when the member or associated person has material, non-public market information concerning an imminent block transaction [6] in the underlying security. Similarly, the same prohibition applies in the underlying security when the material, non-public market information regarding a block transaction concerns an option or security future on that underlying security.[7] The Front Running Policy also prohibits providing material, non-public market information concerning an imminent block transaction to customers who then trade on the basis of the information. The Front Running Policy is limited to transactions in equity securities and options that are required to be reported on a last sale reporting system and to any transaction involving a security future, regardless of whether the transaction is reported. The prohibitions apply until the information concerning the block transaction has been made publicly available (i.e., ''when [the information] has been disseminated via the tape or high speed communications line of one of those systems, a similar system of a national securities exchange under Section 6 of the Act, an alternative trading system under Regulation ATS, or by a third-party news wire service'').

Finally, the Front Running Policy includes exceptions from the general prohibitions in the rule for ''transactions executed by member participants in automatic execution systems in those instances where participants must accept automatic executions'' as well as situations where a member receives a customer's block order relating to both an option or security future and the underlying security and the member, in furtherance of facilitating the customer's block order, positions the other side of one or both components of the order. In the latter case, a member is still prohibited from covering any resulting proprietary position by entering an offsetting order until information concerning the block transaction has been made publicly available.

FINRA is proposing to adopt IM–2110–3 as FINRA Rule 5270 and amend the rule in several ways to broaden its scope and provide further clarity into activity that FINRA believes is inconsistent with just and equitable principles of trade. First, FINRA is proposing to extend the prohibitions in the rule to apply explicitly to all securities and other financial instruments and contracts (*i.e.,* not only options and security futures) that overlay the security that is the subject of an imminent block transaction and that have a value that is materially related to, or otherwise acts as a substitute for, the underlying security. Specifically, FINRA is proposing to extend the front running prohibitions to cover trading in an option, derivative, or other financial instrument overlying a security that is the subject of an imminent block transaction if the value of the underlying security is materially related to, or otherwise acts as a substitute for, such security, as well as any contract that is the functional economic equivalent of a position in such security (individually or collectively a ''related financial instrument''). The reverse would also be true: When the imminent block transaction itself involves a related financial instrument, the proposed rule would prevent trading in the underlying security. The proposed rule change also extends the trading provisions in the rule to include explicitly trading in the same security or related financial instrument that is the subject of an imminent block transaction.[8]

Although the proposed rule change would broaden the scope of trading covered by the front running rule, FINRA believes that the type of trading prohibited by the proposed rule change would generally already violate other existing FINRA rules, such as FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade). As FINRA noted when it first adopted the Front Running Policy, the adoption of the rule was never intended to imply that other forms of trading activity not explicitly covered by the Front Running Policy could not violate FINRA rules.[9] Because FINRA believes the Front Running Policy is unduly narrow in capturing the types of front running activity that are inconsistent with just and equitable principles of trade, FINRA is proposing to broaden the language of the Front Running Policy to apply equally to all related financial instruments (*e.g.,* stock options and futures, options futures, other derivatives, and security-based swaps) rather than be limited to equity securities, security futures, and certain options.[10]

As noted above, the trading restrictions imposed by the current Front Running Policy apply until information about the imminent customer block transaction ''has been made publicly available,'' which the rule defines as having been disseminated to the public in trade reporting data. The proposed rule change generally retains this standard for determining when information has become publicly available; however, because FINRA is proposing to expand the rule to include related financial instruments that may not result in publicly available trading information

[4] Article III, Section 1 of the NASD's Rules of Fair Practice was subsequently renumbered as NASD Rule 2110, and is now FINRA Rule 2010. *See Regulatory Notice* 08–57 (October 2008).

[5] NASD adopted the Front Running Policy at the same time as several other self-regulatory organizations (''SROs'') filed their policies regarding front running of block transactions. *See* Securities Exchange Act Release No. 25233 (December 30, 1987), 53 FR 296 (January 6, 1988). *See also* NASD *Notice to Members* 87–69 (October 1987).

[6] The rule states that ''[a] transaction involving 10,000 shares or more of an underlying security, or options or security futures covering such number of shares is generally deemed to be a block transaction, although a transaction of less than 10,000 shares could be considered a block transaction in appropriate cases.''

[7] The Front Running Policy initially applied only to certain options (either trading the option while in possession of material, non-public market information regarding an imminent block transaction in the underlying security or trading the underlying security while in possession of material, non-public market information regarding an imminent block transaction in the option). In 2002, the rule was broadened to include the same prohibitions with respect to security futures. *See* Securities Exchange Act Release No. 46663 (October 15, 2002), 67 FR 64944 (October 22, 2002); *see also* NASD *Notice to Members* 02–73 (November 2002).

[8] The Commission noted in the release seeking comment on the SRO front running rules that, generally, ''the SROs define frontrunning as the practice of trading a security while in possession of material, non-public information regarding an imminent block transaction in the same or a related security.'' *See* Securities Exchange Act Release No. 25233 (December 30, 1987), 53 FR 296 (January 6, 1988).

[9] FINRA has consistently noted that the Front Running Policy does not provide an exhaustive list of prohibited front running trading. *See* NASD *Notice to Members* 87–69 (October 1987) (''Although the Board believes it is important to provide guidelines describing the kind of [front running] conduct that will not be permitted, members and persons associated with a member should be aware that any conduct that is not consistent with their fiduciary responsibilities in this area would be a violation of [just and equitable principles of trade].''). *See also* NASD *Notice to Members* 96–66 (October 1996) (noting that although the Front Running Policy applied only to equity securities, actions for similar conduct involving government securities would violate just and equitable principles of trade).

[10] Notwithstanding the amendments discussed in the proposed rule change, FINRA notes that, as amended, the rule is still not intended to provide an exhaustive list of prohibited trading activity. Proposed Supplementary Material .05, for example, states that front running orders not explicitly covered by the terms of Rule 5270 could nonetheless violate other FINRA rules.

being made available, FINRA is also proposing that the prohibitions in the rule be in place until the material, non-public market information is either publicly available or ''otherwise becomes stale or obsolete.''[11]

The proposed rule change also replaces several existing provisions in the Front Running Policy with Supplementary Material to FINRA Rule 5270. Specifically, FINRA is proposing to replace the existing exceptions in the Front Running Policy for certain transactions in automatic execution systems and for positioning the other side of certain orders when a member receives a customer's block order relating to both an option and the underlying security or a security future and the underlying security with new Supplementary Material that identifies types of transactions that are permitted under the rule.

Under the Supplementary Material, there are three broad categories of permitted transactions: Transactions that the member can demonstrate are unrelated to the customer block order, transactions that are undertaken to fulfill or facilitate the execution of the customer block order, and transactions that are executed, in whole or in part, on a national securities exchange and comply with the marketplace rules of that exchange.

The first category of permitted transactions is [*sic*] those that the member can demonstrate are unrelated to the customer block order. Supplementary Material .04(a) recognizes that members may engage in such transactions provided that the member can demonstrate that the transactions are unrelated to the material, non-public market information received in connection with the customer order. The Supplementary Material includes an illustrative list of potentially permitted transactions as examples of transactions that, depending upon the circumstances, may be unrelated to the customer block order. These types of transactions could include transactions where the member has effective information barriers established to prevent internal disclosure of customer order information,[12] transactions in the security that is the subject of the customer block order that are related to a prior customer order in that security, transactions to correct bona fide errors, and transactions to offset odd-lot orders.

For each of these types of transactions, the member must be able to demonstrate that the transaction at issue was unrelated to the customer block order. Thus, for example, if the member can demonstrate that transactions occurring in a security (or a related financial instrument) that is the subject of an imminent customer block order were undertaken by a desk that is walled off from the desk handling the customer block order by the use of effective information barriers, the trading activity would be unrelated to the customer block order and, therefore, permitted.[13]

Similarly, FINRA believes that transactions that a member can demonstrate are related to other customer orders in the same security, correct bona fide errors made in earlier transactions involving the security, or offset other odd-lot orders in the security are generally unrelated to the customer block order and therefore should be permitted.

The second category of permitted transactions involves [*sic*] transactions that are undertaken to fulfill or facilitate the execution of the customer block order. FINRA has acknowledged that firms are permitted to trade ahead of a customer's block order when the purpose of such trading is to fulfill the customer order and when the customer has authorized such trading, including that the firm has disclosed to the customer that it may trade ahead of, or alongside of, the customer's order.[14] Supplementary Material .04(b) thus makes clear that Rule 5270 does not preclude transactions undertaken for the purpose of fulfilling, or facilitating the execution of, a customer's block order.[15] However, when engaging in trading activity that could affect the market for the security that is the subject of the customer block order, the member must minimize any potential disadvantage or harm in the execution of the customer's order, must not place the member's financial interests ahead of those of its customer, and must obtain the customer's consent to such trading activity. The Supplementary Material provides that a member may obtain its customers' consent through affirmative written consent or through means of a negative consent letter. The negative consent letter must clearly disclose to the customer the terms and conditions for handling the customer's orders, and if the customer does not object, then the member may reasonably conclude that the customer has consented and may rely on the letter. In addition, a member may provide clear and comprehensive oral disclosure to, and obtain consent from, the customer on an order-by-order basis, provided the member documents who provided the consent and such consent evidences the customer's understanding of the terms and conditions for handling the customer's order.

The third, and final, category of permitted transactions is addressed in Supplementary Material .04(c) and concerns transactions that are executed, in whole or in part, on a national securities exchange and comply with the marketplace rules of that exchange. This provision, which is being proposed in response to comments received from exchanges, states that the prohibitions in Rule 5270 shall not apply if the member's trading activity is undertaken in compliance with the marketplace rules of a national securities exchange and at least one leg of the trading activity is executed on that exchange.[16] This provision recognizes that it is not FINRA's intent to introduce conflicts with other existing SRO rules.

Finally, FINRA is proposing to adopt Supplementary Material .05 to the rule to reiterate that the front running of any customer order, not just imminent block transactions, that places the financial interests of the member ahead of those

[11] Whether information has become stale or obsolete will depend upon the particular facts and circumstances involved, including specific information the member has regarding the transaction, but could include factors such as the amount of time that has passed since the member learned of the block transaction, subsequent trading activity in the security, or a significant change in market conditions.

[12] In addition to more traditional information barriers, such as those in place to prevent communication between trading units, this provision could also include the use of automated systems (e.g., trades through a ''black box'') where the orders placed into the automated system are handled without the knowledge of a person associated with the member who may be trading in the same security. However, a person associated with a member who places an order into a ''black box'' or other automated system, or otherwise has knowledge of the order or the ability to access information in the system, may not then trade in the same security or a related financial instrument solely because the order ultimately was being handled by the automated system rather than by the person. Traders who have no knowledge of the order, due to the presence of an information barrier or otherwise, could continue to trade in the security or a related financial instrument. *See infra* note 23.

[13] FINRA believes that this approach is compatible with the existing provisions concerning customer order protection in Rule 5320 and its accompanying Supplementary Material concerning protection of customer limit and market orders and the implementation of effective information barriers.

[14] *See* NASD *Notice to Members* 05–51 (August 2005); NASD *Notice to Members* 97–57 (September 1997). Hedging and positioning activity around a customer block order was discussed in coordinated guidance published by both NASD and NYSE in 2005 with respect to volume-weighted average price transactions. *See* NASD *Notice to Members* 05–51 (August 2005); NYSE *Information Memo* 05–52 (August 2005).

[15] These transactions may include, for example, hedging or other positioning activity undertaken in connection with the handling of the customer order.

[16] *See infra* note 21.

of its customer or the misuse of knowledge of an imminent customer order may violate other FINRA rules, including FINRA Rules 2010 and 5320, or the federal securities laws.[17]

FINRA will announce the implementation date of the proposed rule change in a *Regulatory Notice* to be published no later than 90 days following Commission approval. The implementation date will be no later than 90 days following publication of the *Regulatory Notice* announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[18] which requires, among other things, that FINRA rules must 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. The proposed rule change clarifies the types of front running trading activity that FINRA believes are inconsistent with just and equitable principles of trade while also ensuring that members may continue to engage in transactions that do not present the risk of abusive trading practices that the rule is intended to prevent. FINRA believes that expanding the terms of the rule beyond options and security futures will enhance the protection of customer orders by addressing more directly within the rule other types of abusive trading that may be intended to take advantage of customer orders. By broadening the scope of prohibited trading activity addressed in the rule, FINRA believes that imminent customer block orders will be better protected and that the proposed rule change will prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and better protect investors and the public interest.

The proposed rule change also specifically identifies three categories of trading activity that are permitted so that the expanded rule will not hamper legitimate trading activity to the detriment of customers, firms, or the market: Transactions that the member can demonstrate are unrelated to the customer block order, transactions that are undertaken to fulfill or facilitate the execution of the customer block order, and transactions that are executed, in whole or in part, on a national securities exchange and comply with the marketplace rules of that exchange. FINRA believes that permitting the trading activity in each of these three categories is consistent with promoting just and equitable principles of trade and protecting investors and the public interest and will not result in fraudulent and manipulative acts and practices. As discussed in Section (a), FINRA believes that transactions that the member can demonstrate are unrelated to the customer block order do not present the potential for abusive trading practices that can disadvantage a customer's order in violation of the rule. FINRA believes that transactions that are undertaken to fulfill or facilitate the execution of the customer block order similarly do not present the potential for abuse the rule is designed to prohibit but also will allow trading activity that can enhance the execution of a customer block order, thus promoting just and equitable principles of trade and protecting investors. Finally, FINRA believes that permitting transactions that are executed, in whole or in part, on a national securities exchange and comply with the marketplace rules of that exchange is consistent with Section 15A(b)(6) of the Act.[19] The marketplace rules of the exchanges that may otherwise conflict with the proposed rule change have been approved by the Commission and found consistent with the Act. Consequently, FINRA believes it promotes just and equitable principles of trade to permit specific trading activity allowed under other approved SRO rules that would otherwise be brought within the broader prohibitions of the proposed rule change.

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

The proposed rule change was published for comment in *Regulatory Notice* 08–83 (December 2008). FINRA received three comment letters in response to the *Regulatory Notice.*[20]

One commenter, NYSER, agreed with FINRA's proposals in *Regulatory Notice* 08–83 to broaden the scope of the rule by extending the prohibitions to include trading in the same security as well as other derivative securities and to add a consent provision for certain hedging or positioning activities in relation to a customer order. However, NYSER requested clarification on when information becomes ''publicly available'' under the proposed rule. Specifically, NYSER wanted clarification regarding whether the proposed rule was intended to apply to trading activity conducted in compliance with certain NYSE, NYSE Arca, and NYSE Amex rules that permit trading based on information related to imminent block transactions when the information has not yet been disseminated via a last sale reporting system but, rather, has entered the market in other ways (e.g., through gapped quotes or disclosure to a trading crowd in the context of anticipatory hedging with respect to options, which is permitted by rule by the options exchanges).[21]

By extending the front running prohibitions to explicitly cover types of securities other than options and security futures, FINRA intends to make clear that misusing material, non-public market information concerning an imminent customer block order is impermissible, regardless of the type of security that is the subject of the order and/or the front running transaction. It is not FINRA's intent to prohibit legitimate trading activity or to supersede other existing SRO rules. Consequently, FINRA has amended the proposed rule change and added a paragraph to the Supplementary Material regarding permitted transactions to clarify that trading will not violate FINRA Rule 5270 if such trading activity is permitted pursuant to the rules of an exchange and at least one leg of the transaction is executed on that exchange.

In its comment letter, SIFMA raises a number of concerns regarding the proposed changes. First, SIFMA opposes the proposed expansion of the rule beyond equity securities or to non-publicly-reported block trades because of the attenuated opportunity for firms to inappropriately benefit from the

[17] Although ''not held'' orders are not subject to the restrictions in FINRA Rule 5320, front running a ''not held'' order that is not of block size may nonetheless violate FINRA Rule 2010. *See* Securities Exchange Act Release No. 63895 (February 11, 2011), 76 FR 9386 (February 17, 2011). If the ''not held'' order is of block size, the proposed rule change would apply to trading activity ahead of the order.

[18] 15 U.S.C. 78*o*–3(b)(6).

[19] 15 U.S.C. 78*o*–3(b)(6).

[20] Letter from International Association of Small Broker-Dealers and Advisors (''IASBDA''), dated January 16, 2009; Letter from Securities Industry and Financial Markets Association (''SIFMA''), dated February 27, 2009; Letter from NYSE Regulation, Inc. (''NYSER''), dated July 22, 2009.

[21] *See* NYSE Arca Rules 6.47A, 6.49(b); NYSE Amex Options Rules 934.3NY; 935NY. FINRA notes that other options exchanges also have trading rules that may, in some scenarios, conflict with the proposed rule change. *See* CBOE Rule 6.9(e).

trade, absent dissemination, and the practical issues of when knowledge of a non-reported block trade is ''stale and obsolete.'' FINRA disagrees and believes that the front running rule should be broadened to include all securities, including fixed income securities, and related financial instruments. The primary issue the proposed rule change is designed to address is straightforward: firms should not use their knowledge of imminent block transactions to benefit themselves at the expense of their customers. This fundamental obligation applies any time a firm misuses this type of information to gain a benefit, regardless of what specific securities or financial products are at issue. Consequently, FINRA has proposed to make clear that front running concerns are not limited to securities futures and options and encompass the trading of any security or related financial instrument under the circumstances outlined in the rule.

FINRA recognizes, however, that because the terms of the front running rule are broad, it could capture trading activity that should otherwise be permitted. To balance this expansion, FINRA is also proposing Supplementary Material .04 that lays out the types of trading activity that would not violate the rule and would be permissible.[22] The sole purpose of Supplementary Material .04 is to ensure that appropriate trading activity not be prohibited by the breadth of the rule. In response to comments by SIFMA, FINRA has modified portions of proposed Supplementary Material .04 as discussed above.[23]

SIFMA also requested that FINRA provide guidance and/or objective standards concerning the scope of the term ''related financial instrument.'' For example, SIFMA suggested a rebuttable presumption with a more objective standard with respect to basket and index transactions and noted that some financial instruments, such as variable swaps and volatility swaps, are ''marginally linked to equity securities'' and are ''sufficiently complex'' that it is ''virtually impossible'' to determine on a trade-by-trade basis whether they would be considered to be ''related financial instruments.''

The proposed rule change defines a ''related financial instrument'' as ''any option, derivative, security-based swap, or other financial instrument overlying a security, the value of which is materially related to, or otherwise acts as a substitute for, such security, as well as any contract that is the functional economic equivalent of a position in such security.'' FINRA believes that the materiality standard used in the proposed rule is a common and well-understood standard in the securities industry. FINRA acknowledges SIFMA's concerns about the increasing variety of financial products and the complex nature of the relationships across products. It is for that exact reason that FINRA believes a materiality standard is appropriate and necessary in the context of the front running rule to ensure each instrument and its impact across products is properly reviewed by members and evaluated with respect to the potential for front running. FINRA also notes that the proposed rule change would extend only to those swaps that are security-based swaps.

SIFMA also commented on the continued use of the term ''block transaction'' in the proposed rule and recommended that FINRA replace the definition of ''block transaction'' and focus instead on ''material transactions.'' FINRA believes that the definition of ''block transaction,'' coupled with the proposed new supplementary material regarding non-block transactions, is sufficiently fluid to capture the appropriate transactions. The definition of ''block transaction'' makes clear that the 10,000-share threshold is not a strict standard and that transactions involving fewer shares could be considered a block transaction; moreover, a transaction more than 10,000 shares is only ''generally'' deemed to be a block transaction for purposes of the rule. The addition of Supplementary Material .05 also clarifies that the front running of other types of orders that may not be ''imminent block transactions'' may nonetheless be considered conduct inconsistent with just and equitable principles of trade and may violate other FINRA rules or provisions of the federal securities laws because such transactions may have violated the animating purpose of the rule that firms should not use their knowledge of imminent customer orders to benefit themselves.

SIFMA also suggested amending the definition of ''customer'' for purposes of the rule to exclude other institutions, such as banks and unregistered affiliates of broker-dealers. SIFMA's underlying concern is that a disclosure-based approach in the trading of OTC equity derivatives is more appropriate given that the counter-parties in such transactions are generally sophisticated institutional investors who are, nonetheless, included in the general FINRA definition of ''customer'' since such investors are not broker-dealers.[24] As an initial matter, FINRA believes that the amendment suggested by SIFMA to exclude banks, branches of foreign banks, or unregistered affiliates of a broker-dealer from the definition of ''customer'' for purposes of the rule is too broad. To exclude sophisticated institutional investors from the definition of ''customer'' is inappropriate given the use of the term throughout the rule for provisions that should include all customers, including sophisticated investors (e.g., prohibiting a member or an associated person of the member from providing material, non-public market information to ''customers'' to allow them to trade on the information). To address SIFMA's underlying concern regarding the proposed rule change's potential impact on the trading of OTC equity derivatives, FINRA notes that Supplementary Material .04 recognizes that certain trading can be affected provided the firm has received its customer's consent, which can be through negative consent.

Two commenters also requested that FINRA provide guidance on the knowledge standard in Supplementary Material .01, which provides that the violative practices set forth in the rule ''may include transactions that are executed based upon knowledge of less than all of the terms of the block transaction, so long as there is knowledge that all of the material terms of the transaction have been or will be agreed upon imminently.'' [25] This

[22] As noted above, Supplementary Material .04 would replace the existing provisions in the Front Running Policy regarding exceptions for transactions executed in automatic execution systems and positioning activity when a member receives an order of block size relating to both an option or security future and the underlying security. Similarly, FINRA had proposed in its *Regulatory Notice* an exception for riskless principal trades; however, this exception is not separately included as it would fall within the scope of Supplementary Material .04. FINRA believes that proposed Supplementary Material .04 covers permissible trading activity under the proposed rule change. Any trading activity that falls within the current exceptions in the Front Running Policy would need to meet one of the exceptions in the proposed Supplementary Material in order to be excepted from the rule. *See* SIFMA.

[23] In addition to the modifications discussed above, FINRA has removed the general exception for '''black box' orders where the member has no actual knowledge that the customer order has been routed for execution,'' which was proposed as part of Supplementary Material .04 in *Regulatory Notice* 08–83. As discussed above in footnote 12, automated systems may serve as a means by which orders are handled and information regarding those orders is unavailable to other trading units; however, FINRA believes that the use of an automated system should not permit trading by those persons who may know the terms of the order placed into the automated system.

[24] *See* FINRA Rule 0160(b)(4).

[25] *See* IASBDA, SIFMA.

provision, which remains substantively the same as the current standard in the Front Running Policy, is intended to make clear that a member need not know every detail of a potential block order for the front running prohibitions to attach. As SIFMA noted, FINRA has provided guidance in the past in the context of volume-weighted average price transactions. For example, in NASD *Notice to Members* 05–51, FINRA stated that a duty to refrain from trading may exist ''before a member is awarded an order for execution [and] will turn on, among other factors, the type of order and the specifics of the order known by the member,'' which may include the security, the size of the order, the side of the market, the weighting of a basket order, and the timing for completion of the order. As this guidance recognizes, exactly when the front running prohibitions may attach depends upon the facts and circumstances of the communications between the member and its customer.

Finally, SIFMA commented on the proposed rule change's potential effects on the trading of OTC equity derivatives. SIFMA believes the proposed rule change will require firms to substantially reorganize their OTC equity derivatives operations to set up unwarranted information barriers to accommodate their trading, given that customer-facing OTC equity derivatives trading desks can be the same desks that manage the risk of the firm's overall OTC equity derivatives book. SIFMA asserts that the current regime of disclosure to sophisticated customers and counterparties works well for OTC equity derivatives (e.g., ISDA Master Agreements). FINRA does not believe that the proposed rule change would necessitate the imposition of unwarranted information barriers. FINRA believes that the provisions regarding permitted transactions in proposed Supplementary Material .04, as amended from the form proposed in *Regulatory Notice* 08–83 in response to comments, are broad enough to exclude appropriate trading activity from the scope of the rule, including trading activity that the member can demonstrate is unrelated to the material, non-public market information received in connection with an imminent customer block order.

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

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

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 email to *rule-comments@sec.gov*. Please include File Number SR–FINRA–2012–025 on the subject line.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–FINRA–2012–025. This file number should be included on the subject line if email is used. To help the Commission process 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 Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. 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–2012–025 and should be submitted on or before June 27, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[26]

Kevin M. O'Neill,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–67088; File No. SR–FINRA–2012–024]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to FINRA Rule 4210 Margin Requirements

May 31, 2012.

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 May 23, 2012, Financial Industry Regulatory Authority, Inc. (''FINRA'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change as described in Items I, II and III below, which Items have been prepared by FINRA. 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 FINRA Rule 4210 (Margin Requirements) to: (1) Revise the definitions and margin treatment of option spread strategies; (2) clarify the maintenance margin requirement for non-margin eligible equity securities; (3) clarify the maintenance margin requirements for non-equity securities; (4) eliminate the current exemption from the free-riding prohibition for designated accounts; (5) conform the definition of ''exempt account''; and (6) eliminate the requirement to stress test portfolio margin accounts in the aggregate. In addition, the proposed rule change would amend FINRA Rule 4210 to make non-substantive technical and stylistic changes.

The text of the proposed rule change is available on FINRA's Web site at

[26] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.