

Retrospective Rule Review

FINRA Requests Comment on the Effectiveness and Efficiency of Its Payments for Market Making Rule

Comment Period Expires: January 29, 2018

Summary

FINRA is conducting a retrospective review of the rule governing payments for market making to assess its effectiveness and efficiency. This *Notice* outlines the general retrospective rule review process and seeks responses to several questions related to firms' experiences with this specific rule.

Questions regarding this *Notice* should be directed to:

- ▶ Racquel Russell, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8363 or by email at racquel.russell@finra.org;
- ▶ Cara Rosen, Counsel, OGC, at (202) 728-8852 or by email at cara.rosen@finra.org; or
- ▶ Shawn O'Donoghue, Economist, Office of the Chief Economist, at (202) 728-8273 or by email at Shawn.Odonoghue@finra.org.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by January 29, 2018.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to pubcom@finra.org; or
- ▶ Mailing comments in hard copy to:
Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

November 28, 2017

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Market Making
- ▶ Operations
- ▶ Senior Management
- ▶ Trading

Key Topics

- ▶ Market Making

Referenced Rules & Notices

- ▶ FINRA Rule 5250
- ▶ Notice to Members 75-16
- ▶ Regulatory Notice 17-14

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

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.

Background and Discussion

FINRA believes that it is appropriate, after a reasonable period of time, to look back at its significant rulemaking to determine whether a FINRA rule or rule set² is meeting its intended investor-protection objectives by reasonably efficient means. FINRA further believes that a retrospective review should include a review not only of the substance and application of a rule or rule set, but also FINRA's processes to administer the rules. FINRA intends to select relevant rules and to conduct retrospective rule reviews on an ongoing basis to ensure that its rules remain relevant and appropriately designed to achieve their objectives, particularly in light of environmental, industry and market changes.

In conducting the review, FINRA staff will follow a similar process to previous retrospective rule reviews. In general, the review process consists of an assessment and action phase. During the assessment phase, FINRA will evaluate the efficacy and efficiency of the rule or rule set as currently implemented, including FINRA's internal administrative processes. FINRA will seek input from affected parties and experts, including its advisory committees, subject-matter experts inside and outside of the organization, and other stakeholders, including industry members, investors, interested groups and the public. FINRA staff will assess issues including the existence of duplicative, inconsistent or ineffective regulatory obligations; whether market or other conditions have changed to suggest there are ways to improve the efficiency or effectiveness of a regulatory obligation without loss of investor protections; and potential gaps in the regulatory framework. Upon completion of this assessment, FINRA staff will consider appropriate next steps, which may include some or all of the following: modifications to the rule, updated or additional guidance, administrative changes or technology improvements, or additional research or information gathering.

The action phase will then follow. To the extent action involves modification of rules, FINRA will separately engage in its usual rulemaking process to propose amendments to the rules based on the findings. This process will include input from FINRA's advisory committees and an opportunity for comment on specific proposed revisions in a Regulatory Notice or rule filing with the SEC, or both.

Request for Comment

FINRA received comments on Rule 5250 (Payments for Market Making) in response to *Regulatory Notice 17-14*, which requested comment on FINRA rules impacting capital formation.³ FINRA believes it would be useful to solicit further comment on the effectiveness and efficiency of Rule 5250 as part of the retrospective rule review process. Rule 5250 explicitly prohibits a member or associated person from accepting payment or other consideration, directly or indirectly, from an issuer or its affiliates and promoters, for publishing a quotation, acting as a market maker or submitting an application in connection therewith. The rule excepts: (1) payment for bona fide services, including, but not limited to, investment banking services (including underwriting compensation and fees); (2) reimbursement of any payment for registration imposed by the SEC or state regulatory authorities and for listing fees imposed by a self-regulatory organization; and (3) any payment expressly provided for under the rules of a national securities exchange that are effective after being filed with, or filed with and approved by, the SEC pursuant to the requirements of the Exchange Act.

The prohibition on accepting payments for market making, originally articulated in a *Notice to Members* in 1975 and codified in 1997, is intended to assure that members act in an independent capacity when publishing a quotation or making a market in an issuer's securities.⁴ FINRA has stated that such payments may be viewed as a conflict of interest since they may influence the member's decision as to whether to quote or make a market in a security and, thereafter, the prices that the member would quote.

FINRA seeks answers to the following questions with respect to this rule:

1. Has the rule effectively addressed the problem(s) it was intended to mitigate? To what extent have the original purposes of and need for the rule been affected by subsequent changes to the markets, the delivery of financial services, the applicable regulatory framework or other considerations? Are there alternative ways to achieve the goals of the rule that FINRA should consider?
2. What has been your experience with implementation of the rule, including any ambiguities in the rule or challenges to comply with it?
3. What have been the economic impacts, including costs and benefits, arising from FINRA's rule? Have the economic impacts been in line with expectations described in the rulemaking? To what extent would these economic impacts differ by business attributes, such as size of the firm or differences in business models? Has the rule led to any negative unintended consequences?
4. Can FINRA make the rule, interpretations or attendant administrative processes more efficient and effective?

In addition to comments responsive to these questions, FINRA invites comment on any other aspects of the rule that commenters wish to address. FINRA further requests any data or evidence in support of comments. While the purpose of this *Notice* is to obtain input as to whether or not the current rule is effective and efficient, FINRA also welcomes specific suggestions as to how the rule should be changed. As discussed above, FINRA will separately consider during the action phase specific changes to the rule.

Endnotes

1. Persons submitting comments are cautioned that FINRA does not redact or edit personal identifying information, such as names or email addresses, from comment submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.
2. A rule set is a group of rules identified by FINRA staff to contain a similar subject, characteristics or objectives.
3. *See* letter to Joseph Price, Senior Vice President and Counsel, FINRA, from Vincent R. Molinari, Chief Executive Officer, and Joseph K. Latona, Ouisa Capital, LLC, dated June 20, 2017; letter to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, from Chris Concannon, President and COO, Cboe Global Markets, Inc., dated November 22, 2017.
4. *See* Securities Exchange Act Release No. 38812 (July 3, 1997), 62 FR 37105 (July 10, 1997) (Order Approving File No. SR-NASD-97-29) and *Notice to Members 75-16* (February 20, 1975).