

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-57259; File No. SR-FINRA-2008-001)

February 1, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to Amendments to FINRA's Gross Income Assessment and Technical Changes to Schedule A to FINRA's By-Laws

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 10, 2008, the 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 substantially prepared by FINRA.<sup>3</sup> 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 Schedule A to the FINRA By-Laws to amend the Gross Income Assessment ("GIA") paid by each FINRA member and to update the references to NASD that appear in Schedule A to the FINRA By-Laws. The text of the proposed rule change is available at NASD, the Commission's Public Reference Room, and <http://www.finra.org>.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Certificate of Incorporation to reflect its name change to the Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Securities Exchange Act Release No. 56145 (July 26, 2007), 72 FR 42169 (August 1, 2007).

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

On July 30, 2007, NASD and the New York Stock Exchange ("NYSE") consolidated their member firm regulation operations into a combined organization, FINRA. The proposed rule change seeks to consolidate certain regulatory fees imposed by NASD and NYSE Regulation, Inc. ("NYSE Regulation") to develop a single fee structure for FINRA that avoids duplicating fees charged by the two organizations.

FINRA's member regulatory pricing structure currently consists primarily of the following fees: the GIA; the Trading Activity Fee ("TAF"); the Personnel Assessment ("PA"); and the Branch Office Assessment ("BOA"). As part of the consolidation, NYSE committed to transfer to FINRA certain regulatory revenues for the remainder of 2007.<sup>4</sup> NYSE fees subject to the transfer agreement include a gross FOCUS (Financial and Operational Combined Uniform Single Report) fee ("GFF")<sup>5</sup> (comparable to NASD's GIA)<sup>6</sup> and registration fees for branch

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<sup>4</sup> See Securities Exchange Act Release No. 56145 (July 26, 2007); 72 FR 42169 (August 1, 2007) (Order Approving SR-NASD-2007-023).

<sup>5</sup> See Securities Exchange Act Release No. 56181 (August 1, 2007), 72 FR 44206 (August 7, 2007) (Notice of Filing and Immediate Effectiveness of SR-NYSE-2007-70).

offices<sup>7</sup> (comparable to NASD's Branch Office System Processing Fee)<sup>8</sup> and registered representatives<sup>9</sup> (comparable to NASD's registration fees for the registration of representatives or principals).<sup>10</sup>

In anticipation of the termination of the agreement to remit fees collected by NYSE, FINRA evaluated whether to consolidate or eliminate any duplicative fees, as well as whether to maintain or increase any non-duplicative fees. FINRA undertook its regulatory pricing review with the objectives of maintaining a fair assessment level for firms and of preserving revenue levels necessary to fund FINRA's member regulatory activities, including the regulation of members through examination, policymaking, rulemaking and enforcement activities.

To achieve these objectives, FINRA determined that the most appropriate regulatory pricing structure would be to: (1) eliminate NYSE Regulation's legacy registration fees for branch offices and registered representatives, which totals approximately \$18.6 million in fee reductions;<sup>11</sup> (2) maintain NASD's fee structures and levels for the TAF, the BOA and the PA; and (3) consolidate, with certain adjustments, NASD's GIA rate structure with NYSE Regulation's GFF rate structure.<sup>12</sup>

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<sup>6</sup> See Section 1(c) of Schedule A.

<sup>7</sup> See NYSE Rule 342, Supplementary Material .11.

<sup>8</sup> See Section 4(a) of Schedule A.

<sup>9</sup> See NYSE Rule 345, Supplementary Material .14.

<sup>10</sup> See Section 4(b) of Schedule A.

<sup>11</sup> See Securities Exchange Act Release No. 57093 (January 3, 2008), 73 FR 1654 (January 9, 2008) (Notice of Filing and Immediate Effectiveness of SR-NYSE-2007-127).

<sup>12</sup> The NYSE will continue to charge its member organizations an annual gross FOCUS fee; however, the fee was reduced by 75 percent beginning in 2008. See Securities Exchange Act Release No. 56181 (August 1, 2007), 72 FR 44206 (August 7, 2007) (Notice of Filing and Immediate Effectiveness of SR-NYSE-2007-70). The reduced gross FOCUS fee charged by NYSE will be retained by NYSE and will not be forwarded to FINRA.

The GIA is currently assessed through a three-tier rate structure with a minimum GIA of \$1,200.00. Under the current GIA, members are required to pay an annual GIA equal to the greater of \$1,200.00 or the total of:

- (1) 0.125% of annual gross revenue less than or equal to \$100 million;
- (2) 0.029% of annual gross revenue greater than \$100 million up to \$1 billion; and
- (3) 0.014% of annual gross revenue greater than \$1 billion.<sup>13</sup>

In contrast, the legacy GFF was assessed at a flat rate of \$0.42 per \$1,000 of gross FOCUS revenue (or 0.042%).

To consolidate these two legacy fees, FINRA proposes that the minimum assessment under the GIA of \$1,200.00 will remain, with the ceiling increased from \$960,000.00 to \$1 million of annual assessable revenue. Because FINRA has committed to reduce the GIA by \$1,200.00 per year for five years, subject to annual Board approval, this will effectively reduce the GIA to \$0 for the first \$1 million of annual assessable revenue. FINRA proposes that for annual gross revenue over \$1 million, the regressive rate structure of the legacy GIA and the flat rate structure of the legacy GFF be combined into a new rate structure. Specifically, FINRA proposes to create a seven-tiered rate structure that balances the legacy GIA tiered rate structure with the legacy GFF flat rate structure.

Under the proposed rule change, members will be assessed a GIA of:

- (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;

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<sup>13</sup> 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.

- (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.

FINRA estimates that the proposed rule change will result in aggregate fee reductions of approximately \$25 million dollars in 2008 and forward, approximately \$18.6 million of which relates to the elimination of NYSE Regulation's legacy registration fees and approximately \$6.4 million for GIA rebates given to all FINRA member firms. FINRA estimates that, under the proposed rate structure described above, 93 percent of member firms will have either no change to their GIA or a reduced GIA due to this new rate structure. Certain firms with annual gross revenue exceeding \$35 million dollars, however, will have an increase to their GIA under the proposed rate structure.

To minimize the impact on members, the new rate structure will be implemented over a three-year period beginning in 2008. During this period, the change in the GIA paid to FINRA by each member will be subject to a cap based on the fees that the member would have paid under the prior NASD and NYSE rate structures. In 2008, a member's GIA will not be impacted by the new rate structure. In 2009, any increase or decrease to the member's GIA resulting from the new rate structure will be capped at a five percent increase or decrease. In 2010, any increase or decrease to the member's GIA resulting from the new rate structure will be capped at a ten percent increase or decrease. During this implementation period, a firm's GIA may increase or decrease due to a change in the member's assessable revenue from year to year; however, any changes to the firm's GIA that result from the change in rate structure will be subject to the cap.

For firms that were members of NASD only (not NYSE) as of July 30, 2007, the cap will be calculated based upon the GIA that the member firm would have paid under the prior NASD GIA rate structure. For firms that became, or become, FINRA members on or after July 30, 2007 (excluding those firms that were members of NYSE only as of July 30, 2007 and were subsequently required to become FINRA members pursuant to NYSE Rule 2), the cap will be calculated based upon the GIA that the member firm would have paid under the prior NASD GIA rate structure. For firms that were members of the NYSE only (not NASD) as of July 30, 2007, the cap will be calculated based upon the NYSE GFF that the member would have paid under the prior NYSE GFF rate structure.<sup>14</sup> For firms that were members of both NASD and the NYSE as of July 30, 2007 (“Dual Members”), the cap will be calculated based upon the GIA and the GFF that the member would have paid under the prior NASD GIA rate structure and the prior NYSE GFF rate structure.<sup>15</sup>

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<sup>14</sup> In calculating the cap based upon the GFF that a member would have paid under the prior NYSE GFF rate structure, FINRA will use only that portion of the GFF that would have been transferred by the NYSE to FINRA (i.e., 75 percent of the GFF paid by the member firm).

<sup>15</sup> For example, assume that a Dual Member has gross revenue of \$5 billion and assessable revenue (based on the prior year) of \$4.95 billion for each of the first three years of the new fee rate structure. Under the legacy rate structures, the firm would have paid income assessments to FINRA of \$2,512,800 each year (a legacy GFF of \$1,575,000 transferred to FINRA (i.e., 75 percent of the firm’s GFF); a legacy GIA to FINRA of \$939,000; and net of a \$1,200 rebate). Under the new rate structure in the proposed rule filing, the total income assessment charged by FINRA to the firm, without the cap, would be \$1,892,224 (a GIA of \$1,893,424 net of a \$1,200 rebate). This would represent a decrease of \$620,576. However, because the change is capped at zero percent in 2008, the firm would be assessed a GIA under the new rate structure of \$2,512,800 (i.e., the same amount as what the firm would have paid under the two legacy rate structures). In 2009, the firm would pay a GIA of \$2,387,160 (reflecting the maximum five percent change), and in 2010, the firm would pay a GIA of \$2,261,520 (reflecting the maximum ten percent change). As discussed in footnote 12 above, Dual Members will also be subject to a reduced GFF charged by NYSE. Telephone conference between Kathleen O'Mara, Associate General Counsel, FINRA; Carrie DiValerio, Senior Director, FINRA; Nancy

Despite the reduction in revenue that will result from the new rate structure, FINRA believes that the revenue collected under the pricing proposal will fund its member regulatory programs. The integration of the member firm regulation operations of NASD and NYSE into FINRA should take up to three years, given FINRA's need to establish a new examination and enforcement program under a consolidated rule book. A new cost structure and revised pricing structure will be evaluated once the integration is complete.

FINRA is proposing that the effective date of the proposed rule change will be retroactive to January 1, 2008. FINRA will announce the proposed rule change and subsequent approval in a Regulatory Notice.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(5) of the Act,<sup>16</sup> which requires, among other things, that FINRA rules provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system that FINRA operates or controls. FINRA believes that the proposed rule change balances NASD and NYSE Regulation legacy fees in a manner that is consistent with FINRA's statutory obligation under Section 15A(b)(5) of the Act<sup>17</sup> to ensure that its fees are reasonable and equitably allocated. FINRA believes that the modified rates and the introduction of additional tiers appropriately balance the legacy fees. Moreover, FINRA has sought to minimize the impact that the proposed rule change will have on its members by

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Burke-Sanow, Assistant Director, Division of Trading and Markets ("Division"), Commission; and Jan Woo, Special Counsel, Division, Commission, on January 31, 2008.

<sup>16</sup> 15 U.S.C. 78o-3(b)(5).

<sup>17</sup> 15 U.S.C. 78o-3(b)(5).

phasing-in the proposed changes so that the changes will have minimal impact on members for the first three years.

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

Written comments were neither solicited nor received.

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

Within 35 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 NASD consents, the Commission will:

- (A) by order approve 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-



2008-001 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-FINRA-2008-001. This file number should be included on the subject line if e-mail 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 inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. 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-2008-001 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>18</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).