

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58095; File No. SR-FINRA-2008-028)

July 3, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade), FINRA Rule 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices), and FINRA Rule 5150 (Fairness Opinions) in the Consolidated FINRA Rulebook

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 June 13, 2008, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially 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 Rules 2110 (Standards of Commercial Honor and Principles of Trade), 2120 (Use of Manipulative, Deceptive or Other Fraudulent Devices), and 2290 (Fairness Opinions) as FINRA rules in the consolidated FINRA rulebook without material change and to delete Incorporated NYSE Rule 401(a) (Business Conduct), Incorporated NYSE Rule 435 (Miscellaneous Prohibitions), with the exception of paragraph (5), and NYSE Rule Interpretations 401/01 and 401/02. The text of the proposed rule change is available at FINRA, the Commission’s Public Reference Room, and www.finra.org.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 the new consolidated rulebook (“Consolidated FINRA Rulebook”),³ FINRA is proposing to adopt NASD Rules 2110, 2120, and 2290 as FINRA Rules 2010, 2020, and 5150, respectively, in the Consolidated FINRA Rulebook. The rules would be adopted without change, with the exception of re-numbering the rules to reflect the new organizational structure of the Consolidated FINRA Rulebook.⁴ The proposed rule change would also delete Incorporated NYSE Rule 401(a) (including two accompanying Interpretations to the rule) and certain provisions of Incorporated NYSE Rule 435 from the Transitional Rulebook.

³ The current FINRA rulebook consists of two sets of rules: (1) NASD Rules and (2) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together referred to as the “Transitional Rulebook”). The Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). Dual Members also must comply with NASD Rules. For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process).

⁴ This proposal does not address the Interpretive Materials (“IMs”) to NASD Rule 2110, which FINRA advises will be considered in a later phase of the rulebook consolidation process. Consequently, the IMs would remain in the Transitional Rulebook. Telephone conference between Brant Brown, Associate General Counsel, FINRA, Mia Zur, Senior Special Counsel, and Linda Jeng-Braun, Attorney, Commission, on June 27, 2007.

a. FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade)

The proposed rule change would transfer NASD Rule 2110 into the Consolidated FINRA Rulebook as FINRA Rule 2010. Incorporated NYSE Rule 401 (including two accompanying Interpretations to the rule) would be deleted from the Transitional Rulebook.

Section 15A(b)(6) of the Act requires that FINRA design its rules to “promote just and equitable principles of trade.”⁵ The Act’s mandate is reflected in NASD Rule 2110, which requires that members, in the conduct of their business, observe high standards of commercial honor and just and equitable principles of trade. This general ethical standard articulated in NASD Rule 2110 is broader and provides more flexibility than prescriptive regulations and legal requirements. NASD Rule 2110 protects investors and the securities industry from dishonest practices that are unfair to investors or hinder the functioning of a free and open market, even though those practices may not be illegal or violate a specific rule or regulation. NASD Rule 2110 has proven effective through nearly 70 years of regulatory experience.

The Incorporated NYSE Rules also include general ethical rules and associated rule interpretations that correspond to NASD Rule 2110 and other provisions in the FINRA rulebook. Specifically:

- Good Business Practice: Using somewhat different language than NASD Rule 2110, Incorporated NYSE Rule 401(a) requires members at all times to adhere to the principles of good business practice in the conduct of their

⁵ 15 U.S.C. 78q-3(b)(6).

business affairs.⁶ This overarching ethical requirement is subsumed under NASD Rule 2110.

- Firm/Personal Trading: Incorporated NYSE Rule Interpretation 401/01 addresses ethical considerations in connection with transactions by a member or its personnel shortly before or after the member issues a purchase or sale recommendation. These considerations are subsumed under NASD Rules 2110 and 2120.⁷
- Private Sales: Incorporated NYSE Rule Interpretation 401/02 broadly addresses the obligation of members to monitor the activities of associated personnel with respect to their marketing of securities through private sales. These obligations are addressed by the requirements in NASD Rule 3040 and Incorporated NYSE Rules 407(b) and 407.11.⁸

For the reasons discussed above, FINRA is proposing to transfer NASD Rule 2110 into the Consolidated FINRA Rulebook as FINRA Rule 2010 with no changes. In addition, FINRA

⁶ In addition to the general good business practice requirement in Incorporated NYSE Rule 401(a), paragraph (b) of the rule requires that members maintain written policies and procedures, administered pursuant to the internal control requirements of Incorporated NYSE Rule 342.23, with respect to transmittals of funds or securities, customer changes of address, and customer changes of investment objectives. These provisions duplicate requirements under NASD Rule 3012(a)(2)(B), for which FINRA has requested comments on proposals to relocate them to the supervision rule in the Consolidated FINRA Rulebook. See Regulatory Notice 08-24 (May 2008) (Proposed Consolidated FINRA Rules Governing Supervision and Supervisory Controls) (“Supervision Notice”).

⁷ In addition, Incorporated NYSE Rule Interpretation 401/01 includes an unrelated, obsolete template relating to the identification of counterfeit stock certificates and a cross-reference provision reminding firms of the personal trading restrictions for research analysts under Incorporated NYSE Rule 472(e).

⁸ FINRA has requested comment on a proposal for the provisions concerning private securities transactions in NASD Rule 3040 and Incorporated NYSE Rules 407(b) and 407.11 to be rewritten and relocated to the supervision rule in the Consolidated FINRA Rulebook. See Supervision Notice.

is proposing to delete from the Transitional Rulebook Incorporated NYSE Rule 401(a) and Incorporated NYSE Rule Interpretations 401/01 and 401/02.⁹

b. FINRA Rule 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices)

The proposed rule change would transfer NASD Rule 2120, which is FINRA's general antifraud provision, into the Consolidated FINRA Rulebook as FINRA Rule 2020 with no changes to the rule text. The proposed rule change would also delete Incorporated NYSE Rule 435 (with the exception of paragraph (5)) from the Transitional Rulebook.

NASD Rule 2120, which has remained unchanged for nearly 70 years, states in its entirety that “[n]o member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive, or other fraudulent device or contrivance.” FINRA has used this broad antifraud rule to address a wide variety of manipulative, deceptive, and fraudulent misconduct, including market manipulation,¹⁰ excessive trading,¹¹ insider

⁹ In addition to Incorporated Rule Interpretations 401/01 and 401/02, discussed above, there are two other interpretations under Incorporated NYSE Rule 401. Incorporated NYSE Rule Interpretations 401/03 and 401/04 address member notification requirements in the event of certain organizational or operational changes, such as mergers with or acquisitions of other broker-dealers, or certain conditions that a member organization reasonably believes could lead to capital, liquidity or similar problems. FINRA will be considering the requirements of these remaining two interpretations as part of a later phase of the rulebook consolidation process. Consequently, the proposed rule change would not delete these two interpretations from the Transitional Rulebook.

¹⁰ See, e.g., Terrance Yoshikawa, Securities Exchange Act Release No. 53731 (April 26, 2006), 87 SEC Docket 2924 (finding that the Applicant, by engaging in a repeated and intentional pattern of market manipulation, had violated Section 10(b) of the Act and Rule 10b-5 thereunder, as well as NASD Rule 2120).

¹¹ See, e.g., Michael T. Studer and Castle Securities Corp., 84 S.E.C. 911 (2004) (affirming NASD's decision that the Applicants violated NASD Rules 2510, 2120, and 2110 by churning a customer's account).

trading,¹² and fraudulent misrepresentation.¹³ Given the rule's broad reach and substantial history, FINRA believes the rule should be transferred unchanged into the Consolidated FINRA Rulebook as FINRA Rule 2020.

Although there is no identical NYSE rule equivalent to NASD Rule 2120, Incorporated NYSE Rule 435 includes three provisions that prohibit specific manipulative and fraudulent misconduct that would generally also violate NASD Rules 2110 or 2120. In addition, these provisions of Incorporated NYSE Rule 435 are duplicative of provisions in NASD Rule 5120.¹⁴

- Incorporated NYSE Rule 435(1) prohibits excessive trading by a member for accounts in which the member is directly or indirectly interested if the trading is “excessive in view of his or its financial resources or in view of the market for such security.”
- Incorporated NYSE Rule 435(3)¹⁵ prohibits buying or selling a security at successively higher or lower prices, respectively, for the purpose of improperly

¹² See, e.g., Sidney C. Eng, 67 S.E.C. 2175 (1998) (finding that a preponderance of the record evidence established that, as found by the NASD, the Applicant purchased stock on the basis of material, non-public information and, thus, violated Article III, Sections 1 and 18 (which have been renumbered as NASD Rules 2110 and 2120)).

¹³ See, e.g., Dane S. Faber, 82 S.E.C. 530 (2004) (affirming NASD's finding that the Applicant violated Section 10(b) of the Act and Rule 10b-5 thereunder, and NASD Rules 2110 and 2120 by making misrepresentations and omitting material facts).

¹⁴ See NASD Rule 5120(a), (c), and (d). FINRA has proposed transferring NASD Rule 5120 into the Consolidated FINRA Rulebook as FINRA Rule 6140. See SR-FINRA-2008-021. Paragraph (5) of Incorporated NYSE Rule 435 concerning the circulation of rumors has no precise equivalent in NASD Rule 5120; however, NASD Rule 5120(e) is similar in nature. The proposed rule change does not address Incorporated NYSE Rule 435(5) or its related Interpretation, which FINRA advises will be considered during a later phase of the rulebook consolidation process.

¹⁵ NYSE deleted paragraph (2) of NYSE Rule 435 in 1968 and left the paragraph reserved; thus, there is no rule text for Incorporated NYSE Rule 435(2).

influencing the market price of the security or “making a price which does not reflect the true state of the market in such security.”

- Incorporated NYSE Rule 435(4) prohibits: (1) direct or indirect participation in a manipulative operation, (2) having any interest in the profits of a manipulative operation, and (3) managing or financing a manipulative operation.

Because these three provisions are duplicative of existing NASD rules that FINRA is proposing to transfer into the Consolidated FINRA Rulebook, the proposed rule change would delete these three provisions from the Transitional Rulebook.¹⁶

For the reasons discussed above, FINRA is proposing to transfer NASD Rule 2120 into the Consolidated FINRA Rulebook as FINRA Rule 2020 with no changes. In addition, FINRA is proposing to delete Incorporated NYSE Rule 435 (with the exception of paragraph (5) and its related Interpretation) from the Transitional Rulebook.

c. FINRA Rule 5150 (Fairness Opinions)

The proposed rule change would transfer NASD Rule 2290 into the Consolidated FINRA Rulebook as FINRA Rule 5150 with no changes to the rule text.

NASD Rule 2290 requires specific disclosures and procedures addressing the conflicts of interest that arise when a broker-dealer provides a fairness opinion in a change of control transaction, such as a merger or sale or purchase of assets. The disclosures required by the rule are aimed at informing investor shareholders of potential conflicts, such as whether a member

¹⁶ Incorporated NYSE Rule 435 also includes two other miscellaneous provisions directed at specific issues: (1) a provision in paragraph (6) preventing the reopening of certain contracts for improper purposes, and (2) a provision in paragraph (7) preventing certain types of loans. FINRA believes that these two provisions are obsolete, and the proposed rule change would also delete these provisions from the Transitional Rulebook. The provisions of the Federal Reserve Board’s Regulation T, which governs credit by broker-dealers, would continue to apply to broker-dealers.

has acted as a financial advisor to any party to the transaction that is the subject of the fairness opinion, and if so, whether it will receive compensation contingent on the successful completion of the transaction. The rule also requires disclosure by a member of other significant contingent payments; material relationships with any parties to the transaction; whether information used by the member has been independently verified; whether the opinion expresses an opinion about the fairness of the compensation to officers, directors or employees, relating to that received by public shareholders; and whether the opinion was approved or issued by a fairness committee.

Additionally, NASD Rule 2290 requires that any member issuing a fairness opinion must have written procedures for approval of a fairness opinion. The procedures must address the types of transactions and the circumstances in which the firm will use a fairness committee to approve or issue a fairness opinion, and in those transactions in which it uses a fairness committee: (1) the process for selecting personnel to be on the fairness committee; (2) the necessary qualifications of persons serving on the fairness committee; and (3) the process to promote a balanced review by the fairness committee, which shall include the review and approval by persons who do not serve on the deal team to the transaction. Members are also required to have a process to determine whether the valuation analyses used in the fairness opinion are appropriate.

NASD Rule 2290 was approved by the Commission in October 2007, and was the product of extensive notice and comment rulemaking over a period of several years.¹⁷ FINRA solicited comment on proposed NASD Rule 2290 in a Notice to Members issued in 2004.¹⁸ FINRA modified the proposed rule based upon the comments received, and the Commission

¹⁷ See Securities Exchange Act Release No. 56645 (October 11, 2007), 72 FR 59317 (October 19, 2007) (SR-NASD-2005-080).

¹⁸ See NASD Notice to Members 04-83 (November 2004).

published the proposal for comment in the Federal Register in 2006.¹⁹ The final rule reflects additional changes based upon the comments received by the Commission.²⁰ Consequently, the proposed rule filing would transfer NASD Rule 2290 into the Consolidated FINRA Rulebook as FINRA Rule 5150.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²¹ 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. FINRA believes that the proposed rule change to transfer the rule requiring adherence to just and equitable principles of trade and the rule prohibiting fraudulent and manipulative acts and practices is necessary so that FINRA can continue to enforce these overarching provisions that express FINRA's core regulatory objectives and allow FINRA to effectively protect investors and the public interest. FINRA also believes that the provisions of NASD Rule 2290 benefit investors and the public interest by requiring the disclosure of conflicts of interest in connection with fairness opinions and procedures designed to mitigate those conflicts.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

¹⁹ See Securities Exchange Act Release No. 53598 (April 4, 2006), 71 FR 18395 (April 11, 2006) (SR-NASD-2005-080).

²⁰ See Securities Exchange Act Release No. 56645 (October 11, 2007), 72 FR 59317 (October 19, 2007) (SR-NASD-2005-080).

²¹ 15 U.S.C. 78q-3(b)(6).

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments on the proposed rule change 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 self-regulatory organization 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. Please include File Number SR-FINRA-2008-028 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-FINRA-2008-028. 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 a.m. and 3:00 p.m. 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-2008-028 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.²²

Florence E. Harmon
Acting Secretary

²² 17 CFR 200.30-3(a)(12).