

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-57964; File No. SR-NASD-2006-005)

June 13, 2008

Self-Regulatory Organizations; National Association of Securities Dealers, Inc. (n/k/a Financial Industry Regulatory Authority, Inc.); Order Approving Proposed Rule Change and Amendment No. 1 Thereto to Expand the Scope of NASD Rule 2440 and Interpretive Material 2440-1 Relating to Fair Prices and Commissions to Apply to All Securities Transactions

I. Introduction

On January 19, 2006, the National Association of Securities Dealers, Inc. (“NASD”) (n/k/a Financial Industry Regulatory Authority, Inc. (“FINRA”)), filed with the Securities and Exchange Commission (“Commission”), 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> a proposed rule change to expand the coverage of NASD Rule 2440 and Interpretive Material (“IM”) 2440 relating to fair prices and commissions, to all securities transactions that involve members and their customers.<sup>3</sup> The proposed rule change was published for comment in the Federal Register on April 4, 2006.<sup>4</sup> The Commission received two comment letters regarding the proposal.<sup>5</sup> NASD responded to the comment letters on October 2,

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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> IM-2440-1, which was designated as IM-2440 at the time of this filing, was proposed to be re-numbered in SR-NASD-2003-141, which was filed before this proposal was filed and approved while this proposal was pending. See Securities Exchange Act Release No. 55638 (April 16, 2007), 72 FR 20150 (April 23, 2007) (SR-NASD-2003-141).

<sup>4</sup> See Securities Exchange Act Release No. 53562 (March 29, 2006), 71 FR 16849.

<sup>5</sup> See submission via SEC WebForm from Dan Mayfield, President, Sanderlin Securities, dated April 6, 2006 (“First Commenter”); letter from Mary C.M. Kuan, Vice President and Assistant General Counsel, The Bond Market Association, to Nancy M. Morris, Secretary, Commission, dated May 4, 2006 (“Second Commenter”).

2006.<sup>6</sup> On May 30, 2008, FINRA filed Amendment No. 1 to the proposed rule change.<sup>7</sup> This order approves the proposed rule change, as modified by Amendment No. 1.

## II. Description of the Proposed Rule Change

FINRA proposes to amend NASD Rule 2440, which requires that a member charge fair commissions and service charges, and buy or sell securities at fair prices, in over-the-counter (“OTC”) securities transactions with a customer. FINRA also proposes to amend IM-2440-1, which provides further guidance on the commissions and prices that a member may charge a customer in an OTC transaction. Specifically, FINRA proposes to expand the scope of Rule 2440 and IM-2440-1 to include all securities transactions involving members and their customers, including transactions between members and their customers that are executed on an exchange.<sup>8</sup>

## III. Summary of Comments

The Commission received two comment letters in response to the proposed rule change.<sup>9</sup> One commenter, using the example of a municipal bond that had not sold in several years, stated that the proposed rule was problematic for the same reason that the existing rule was problematic;

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<sup>6</sup> See letter from Stephanie M. Dumont, Vice President and Associate General Counsel, NASD, to Nancy M. Morris, Secretary, Commission, dated October 2, 2006 (“NASD letter”).

<sup>7</sup> In Amendment No. 1, FINRA clarified that the proposed rule change will regulate the charges imposed by members on customers for trades that are executed on an exchange, and not the execution prices that are obtained on the exchange. Because the Amendment is technical in nature, it is not subject to notice and comment.

<sup>8</sup> The proposed amendments would only apply to transactions between members and their customers, and not to transactions among members.

Rule 2440 and IM 2440-1 do not currently apply to municipal securities or exempt securities. This would be unchanged by the proposal.

<sup>9</sup> Supra note 5.

specifically, that a mark-up, especially in a highly illiquid market, may have little relation to fair pricing.<sup>10</sup>

The main concern the other commenter raised was which self-regulatory organization had jurisdiction over the pricing of an exchange transaction.<sup>11</sup> The commenter stated that NASD did not explain how Rule 2440 would be applied to exchange transactions.<sup>12</sup> The commenter questioned whether, under the proposal, NASD and the exchanges would have overlapping authority over exchange transactions,<sup>13</sup> as well as whether NASD had authority under Section 15A of the Act to regulate exchange transactions.<sup>14</sup> The commenter noted that the proposal would result in increased surveillance by NASD of exchange transactions, which NASD could use to justify increasing its regulatory fees for broker-dealers.<sup>15</sup> Finally, the commenter said that, in the event the Commission approves the proposal, it should require NASD to enter into Rule 17d-2 agreements with the various exchanges to minimize regulatory duplication.<sup>16</sup>

In response to the comment letters, NASD said that the First Commenter's submission was not relevant to the proposed rule change, and that the Second Commenter only raised procedural, not substantive, issues.<sup>17</sup> According to NASD, the First Commenter's submission was not germane to the proposed rule change, as it dealt with municipal securities.<sup>18</sup> NASD stated that Rule 2440

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<sup>10</sup> First Commenter at 1.

<sup>11</sup> Second Commenter at 1.

<sup>12</sup> Id. at 4.

<sup>13</sup> Id. at 3.

<sup>14</sup> Id.

<sup>15</sup> Id.

<sup>16</sup> Id. at 4.

<sup>17</sup> NASD letter at 1, 4.

<sup>18</sup> Id. at 1-2.

and IM-2440-1 do not currently apply to municipal securities, and will not apply to municipal securities under the proposed rule change.<sup>19</sup>

In response to the Second Commenter, NASD said that its regulatory jurisdiction is not limited to OTC trading, but encompasses members' conduct on all markets with respect to customer transactions.<sup>20</sup> As such, the application of Rule 2440 and IM-2440-1 should not vary according to where the order is ultimately executed.<sup>21</sup> According to NASD, the proposal will not create duplicative regulation, as it was not aware of another SRO that had established similar rules relating to a member's pricing of transactions with a customer.<sup>22</sup> NASD stated that a Rule 17d-2 agreement was thus inapplicable in this context.<sup>23</sup> Even if another SRO maintained similar rules relating to the pricing of customer transactions, however, NASD said that some regulatory overlap is inevitable, given the existence of multiple SROs.<sup>24</sup> NASD also asserted that it did not intend to change its current formula for calculating regulatory fees for members, and that the proposal would not extend to non-members.<sup>25</sup>

#### IV. Discussion and Commission Findings

The Commission has carefully reviewed the proposed rule change, the comment letters, and NASD's response to the comment letters, and finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national

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<sup>19</sup> Id. at 2.

<sup>20</sup> Id. at 3.

<sup>21</sup> Id.

<sup>22</sup> Id.

<sup>23</sup> Id. at 4.

<sup>24</sup> Id. at 3-4.

<sup>25</sup> Id. at 4.

securities association<sup>26</sup> and, in particular, Section 15A(b)(6) of the Act,<sup>27</sup> which requires, among other things, that FINRA rules 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 Commission believes that the response to comments addressed the concerns the commenters raised. In addition, in Amendment No. 1, FINRA stated that the proposed rule change will apply to charges imposed by members on customers for trades that are executed on an exchange, and not to the execution prices that are obtained on the exchange.

The proposed rule change extends broker-dealer fair pricing obligations to all securities transactions between members and their customers, except for those transactions involving municipal and exempt securities. By extending the requirement to charge fair commissions and mark-ups to customers in connection with exchange transactions, in addition to OTC transactions, the proposed rule change should enhance investor protection.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NASD-2006-005), as modified by Amendment No. 1 be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>28</sup>

Florence E. Harmon  
Acting Secretary

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<sup>26</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>27</sup> 15 U.S.C. 78o-3(b)(6).

<sup>28</sup> 17 CFR 200.30-3(a)(12).