

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-71625; File No. SR-FINRA-2014-009]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend FINRA Rule 5131 (New Issue Allocations and Distributions) To Provide FINRA With General Exemptive Authority

February 27, 2014.

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 February 14, 2014, 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. FINRA has designated the proposed rule change as “constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule” under Section 19(b)(3)(A)(i) of the Act<sup>3</sup> and Rule 19b-4(f)(1) thereunder,<sup>4</sup> which renders the proposal effective upon receipt of this filing by the Commission. 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 5131 (New Issue Allocations and Distributions) to provide FINRA with general exemptive authority under the rule.

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

On September 29, 2010, the SEC approved new FINRA Rule 5131 (New Issue Allocations and Distributions) (the “Rule”), which addresses potential abuses in the allocation and distribution of “new issues.”<sup>5</sup> The Rule also is intended to sustain public confidence in the IPO process, which is critical to the continued success of the capital markets.

Rule 5131(a) (Quid Pro Quo Allocations) prohibits quid pro quo arrangements by providing that no member or person associated with a member may offer or threaten to withhold shares it allocates of a new issue as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member.

Paragraph (b) (Spinning) addresses the practice of “spinning,” where a member allocates shares of a new issue to an executive officer or director of a recent, current or potential investment banking client as an award for retaining the member for investment banking business. Specifically, Rule 5131(b) generally provides that no member may allocate new issue shares to any account in which an executive officer or director of a public company or a covered non-public company has a beneficial interest: (1) if the company is currently an investment banking services client of the member or the member has received compensation from the company for investment banking services in the past 12 months; (2) if the person responsible for making the allocation decision knows or has reason to know that the member intends to provide, or expects to be retained by the company for, investment banking services within the next 3 months; or (3) on the express or implied condition that such executive officer or director, on behalf of the company, will retain the member for the performance of future investment banking services.<sup>6</sup>

<sup>5</sup> Rule 5131 provides that “new issue” shall have the same meaning as in Rule 5130(i)(9).

<sup>6</sup> The spinning provision excepts allocations to certain types of accounts (the accounts described in Rule 5130(c)(1) through (3) and (5) through (10)) as well as any other account in which the beneficial interests of executive officers and directors of the

Paragraph (c) (Policies Concerning Flipping) addresses the imposition of penalties on an associated person in cases where the purchaser of shares of a new issue engages in “flipping.”<sup>7</sup> Specifically, the Rule provides that no member or person associated with a member may directly or indirectly recoup, or attempt to recoup, any portion of a commission or credit paid or awarded to an associated person for selling shares of a new issue that subsequently are flipped by a customer, unless the managing underwriter has assessed a penalty bid on the entire syndicate.<sup>8</sup> Thus, for example, a member may not penalize an associated person by reclaiming a sales commission where the associated person’s customer sells the new issue shares within a short period of the offering, unless the managing underwriter has assessed a penalty bid on the entire syndicate.

Rule 5131(d) (New Issue Pricing and Trading Practices) generally requires: (1) the provision of specified information to the issuer regarding investor interest in the offering, including reports on indications of interest received and final allocations; (2) that lock-up agreements or other restrictions on the transfer of the issuer’s shares by officers and directors of the issuer entered into in connection with a new issue also must apply to any issuer-directed shares and further must provide that the book-running lead manager will notify the issuer of the impending release or waiver and announce the impending release or waiver through a major news service.<sup>9</sup>

In addition, paragraph (d) provides that the agreement between the book-running lead manager and other syndicate members must require, to the extent not inconsistent with SEC Regulation M, that any shares trading at a premium to the public offering price that are returned by a purchaser to a syndicate member after secondary market trading commences must be

company in the aggregate do not exceed 25% of such account.

<sup>7</sup> Rule 5131(e)(4) defines “flipped” as the initial sale of new issue shares purchased in an offering within 30 days following the offering date of such offering.

<sup>8</sup> The flipping provision also provides that, in addition to any obligation to maintain records relating to penalty bids under Rule 17a-2(c)(1) under the Act, a member shall promptly record and maintain information regarding any penalties or disincentives assessed on its associated persons in connection with a penalty bid. Rule 5131(c).

<sup>9</sup> This requirement does not apply to a release or waiver effected solely to permit a transfer of securities that is not for consideration and where the transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor. See Rule 5131(d)(2)(B).

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(i).

<sup>4</sup> 17 CFR 240.19b-4(f)(1).

used to offset the existing syndicate short position. However, if no syndicate short position exists, the member must either: (1) offer the returned shares at the public offering price to unfilled customer orders pursuant to a random allocation methodology, or (2) sell the returned shares on the secondary market and donate profits from the sale to an unaffiliated charitable organization with the condition that the donation be treated as an anonymous donation to avoid any reputational benefit to the member. Finally, Rule 5131(d)(4) (Market Orders) prohibits the acceptance of a market order for the purchase of shares of a new issue in the secondary market prior to the commencement of trading of such shares in the secondary market.

Since Rule 5131 became effective,<sup>10</sup> FINRA states they have received numerous operational and interpretive questions regarding the Rule's various provisions. Most recently, FINRA proposed, and the Commission approved, a new exemption for allocations to certain funds-of-funds.<sup>11</sup> The new exception, codified in Supplementary Material .02, was narrowly tailored to address prevalent operational burdens on members in connection with allocations to certain investment funds, even under circumstances that did not present the concerns that the spinning provision was designed to address. FINRA determined that, in this case, the concerns raised by members and other industry participants concerning the spinning provision could efficiently be addressed through a general exemption to the rule with a common set of conditions designed to provide relief, while also ensuring that allocation activity is not likely to result in the harms sought to be prevented by the Rule.

However, FINRA believes there may be other circumstances where relief is warranted on a case-by-case basis—

<sup>10</sup> Most of the provisions of Rule 5131 became effective on May 27, 2011, except for paragraphs (b) and (d)(4), which became effective on September 26, 2011. See *Regulatory Notices* 10–60 (November 2010) and 11–29 (June 2011).

<sup>11</sup> See Securities Exchange Act Release No. 70312 (September 4, 2013), 78 FR 55322 (September 10, 2013) (Notice of Filing File No. SR–FINRA–2013–037); Securities Exchange Act Release No. 70957 (November 27, 2013), 78 FR 72946 (December 4, 2013) (Order Approving File No. SR–FINRA–2013–037).

Rule 5131(b) previously addressed operational burdens associated with some accounts with a large and diverse ownership base where the potential for spinning is minimal through a series of exemptions for purchasers such as mutual funds, insurance company general accounts and various employee benefit plans. See *supra* note 6. Private funds, however, are not a category of purchasers for which a general exemption exists.

likewise where the concerns the Rule was designed to address are not present. Therefore, FINRA believes it is appropriate to obtain the authority to, in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a person unconditionally or on specified terms from any or all of the provisions of this Rule that it deems appropriate consistent with the protection of investors and the public interest. Exemptive authority would permit members to apply for relief from Rule 5131, pursuant to the Rule 9600 Series, similar to the exemptive authority that exists for FINRA Rule 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings), which shares several attributes with Rule 5131.<sup>12</sup> The 9600 Series sets forth the manner in which application for relief must be made, including that the applicant must provide a detailed statement of the grounds for granting the exemption. FINRA proposes that it would use its exemptive authority only in circumstances that are truly unique.

The implementation date for the proposed rule change will be the date of filing.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>13</sup> 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 adopting an exemptive authority provision furthers these purposes by promoting capital formation and aiding member compliance efforts, while maintaining investor confidence in the capital markets by preserving the efficacy of the rule while permitting members to request an exemption from Rule 5131, where the harms the rule was designed to prevent are not present.

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

FINRA does not believe that the proposed rule change results in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act in that the proposed rule permits members to apply for (and FINRA to grant) exemptive relief under Rule 5131, in exceptional and unusual circumstances, to the extent that such exemption would be

consistent with the purposes of the Rule, the protection of investors and the public interest.

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

Not applicable.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>14</sup> and paragraph (f)(1) of Rule 19b–4 thereunder.<sup>15</sup> At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or 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](mailto:rule-comments@sec.gov). Please include File Number SR–FINRA–2014–009 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–2014–009. 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

<sup>12</sup> See FINRA Rule 5130(h) (Exemptive Relief).

<sup>13</sup> 15 U.S.C. 78o–3(b)(6).

<sup>14</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>15</sup> 17 CFR 240.19b–4(f)(1).

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 a.m. and 3 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-2014-009 and should be submitted on or before March 26, 2014.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>16</sup>

**Kevin M. O'Neill,**  
*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-71630; File No. SR-NYSEMKY-2014-05]

### Self-Regulatory Organizations; NYSE MKT LLC; Order Granting Approval of Proposed Rule Change Amending Its Rules in Order To Clarify the Applicability and Functionality of Certain Order Types on the Exchange

February 27, 2014.

#### I. Introduction

On January 8, 2014, NYSE MKT LLC ("Exchange" or "NYSE MKT") 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 amend its rules in order to clarify the applicability and functionality of certain option order types on the Exchange. The proposed rule change was published for comment in the **Federal Register** on January 21,

2014.<sup>3</sup> The Commission received no comment letters regarding the proposed rule change. This order approves the proposed rule change.

#### II. Description of the Proposal

The Exchange has proposed to amend Rule 900.3NY in order to clarify the applicability and functionality of certain option order types. The Exchange states that it is not proposing to change or alter any obligations, rights, policies or practices enumerated within its rules. Rather, according to the Exchange, this proposal is designed to reduce the potential for investor confusion as to the functionality and applicability of certain option order types presently available on NYSE Amex Options.<sup>4</sup>

The Exchange's proposed revisions to Rule 900.3NY would provide greater detail as to the existing functionality of certain order types, including:

- *Rule 900.3NY(a)—Market Order.* The Exchange has proposed to amend Rule 900.3NY(a) to specify that: (1) Market Orders entered before the opening of trading will be eligible for trading during the Opening Auction Process; (2) Market Orders entered during Core Trading Hours will be rejected if, at the time the order is received, there is no National Best Bid ("NBB") and no National Best Offer ("NBO") (collectively, "NBBO") disseminated by the Options Pricing Reporting Authority ("OPRA") for the relevant option series; and (3) if at the time the Exchange receives a Market Order to buy (sell) there is an NBB (NBO) but no NBO (NBB) being disseminated, the Market Order will be processed pursuant to Rule 967NY(a).<sup>5</sup>
- *Rule 900.3NY(d)(1)–(2)—Stop Orders and Stop Limit Orders.* The Exchange has proposed to amend Rule 900.3NY(d)(1)–(2) to specify that it will reject Stop Orders and Stop Limit Orders to buy entered with a stop price below the bid at the time the order is entered and Stop Orders and Stop Limit Orders to sell entered with a stop price above the offer at the time the order is entered.<sup>6</sup>

- *Rule 900.3NY(o)—NOW Order.* The Exchange has proposed to clarify that a NOW Order that is not marketable

against the NBBO when submitted to the Exchange will be rejected.<sup>7</sup>

The Exchange's additional proposed revisions to Rule 900.3NY would be three-fold. First, the Exchange has proposed to specify in Rules 900.3NY(g) and 900.3NY(i) that One-cancels-the-other Orders and Single Stock Future/Option Orders, respectively, are only eligible for open outcry trading.<sup>8</sup> Second, the Exchange has proposed to decommission the functionality supporting the Inside Limit Order defined in Rule 900.3NY(c) and the Tracking Order defined in Rule 900.3NY(d)(5) due to a lack of demand for these order types. The Exchange states that it does not intend to re-introduce these order types in the future, and thus proposes to delete the text of these rules.<sup>9</sup> Third, the Exchange has proposed to correct typographical errors in the definition of the Opening Only Order in Rule 900.3NY(q).<sup>10</sup>

The Exchange has stated that it plans to issue a Trader Update announcing the changes proposed by this rule filing upon approval of the filing.<sup>11</sup>

#### III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>12</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>13</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers or dealers.

The Exchange believes that the proposed rule change is consistent with, and would further the objectives of, Section 6(b)(5) of the Act because it

<sup>3</sup> See Securities Exchange Act Release No. 71294 (January 14, 2014), 79 FR 3431 ("Notice").

<sup>4</sup> See Notice, 79 FR at 3432.

<sup>5</sup> See proposed Rule 900.3NY(a); see also Notice, 79 FR at 3432.

<sup>6</sup> See proposed Rule 900.3NY(d)(1)–(2); see also Notice, 79 FR at 3432–33. The Commission notes that proposed Rule 900.3NY(d)(1)–(2) accurately sets forth this additional specification, but the Exchange's description of this rule change in the purpose section of its filing refers to stop prices above the bid or below the offer (instead of below the bid or above the offer) triggering rejection.

<sup>7</sup> See proposed Rule 900.3NY(o); see also Notice, 79 FR at 3433.

<sup>8</sup> See proposed Rules 900.3NY(g) and 900.3NY(i); see also Notice, 79 FR at 3433.

<sup>9</sup> See Notice, 79 FR at 3432–33.

<sup>10</sup> See proposed Rule 900.3NY(q); see also Notice, 79 FR at 3433.

<sup>11</sup> See Notice, 79 FR at 3433.

<sup>12</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>16</sup> 17 CFR 200.30-3(a)(12).

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

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