

Recordkeeping Requirements

SEC Approves Amendments Relating to Recordkeeping and the Unsolicited Customer Order Exception of SEA Rule 15c2-11

Effective Date: September 21, 2009

Executive Summary

Effective September 21, 2009, firms are required to create a contemporaneous record of certain customer and order information demonstrating eligibility for the unsolicited customer order exception of SEA Rule 15c2-11 when the firm is relying on such exception.

The text of the amendments can be found in the online *FINRA Manual* at www.finra.org/finramanual.

Questions regarding this *Notice* should be directed to Racquel Russell, Assistant General Counsel, Office of General Counsel, at (202) 728-8363.

Background and Discussion

FINRA Rule 6440 sets forth certain standards applicable to member firms to demonstrate compliance with Rule 15c2-11 under the Securities Exchange Act of 1934 (SEA). SEA Rule 15c2-11 prescribes information review and maintenance requirements for broker-dealers that publish quotations¹ in a quotation medium² for certain over-the-counter equity securities (e.g., those quoted on the OTC Bulletin Board and Pink Sheets). Specifically, SEA Rule 15c2-11 prohibits a broker-dealer from publishing, or submitting for publication, a quotation for a covered OTC equity security unless it has obtained and reviewed current information about the issuer whose security is the subject of the quotation that the broker-dealer believes is accurate and obtained from a reliable source.

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Notice Type

- Rule Amendment

Suggested Routing

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

Key Topic(s)

- Recordkeeping
- Unsolicited Customer Orders

Referenced Rules & Notices

- FINRA Rule 6440
- FINRA Rule 6540
- SEA Rule 15c2-11

There are several exceptions to SEA Rule 15c2-11, including paragraph (f)(2) of the rule, which excepts quotations that represent a customer's unsolicited order or indication of interest (the unsolicited customer order exception).

FINRA has found that firms maintain varying levels of documentation for demonstrating eligibility for the unsolicited customer order exception and, in some cases, have been unable to produce any proof that a quote in fact represented a customer's unsolicited order or indication of interest.

While a firm relying on this or any exception should be able to proffer evidence of its eligibility for and compliance with the exception, FINRA believes that providing specific recordkeeping requirements for demonstrating eligibility for the SEA Rule 15c2-11(f)(2) exception is appropriate and will promote more uniform recordkeeping and compliance with this exception.

Specifically, contemporaneous with the receipt of any unsolicited customer order or indication of interest, firms are now required to record the following details:

- ▶ the identity of the associated person who receives the unsolicited customer order or indication of interest directly from the customer, if applicable;³
- ▶ the identity of the customer;
- ▶ the date and time the unsolicited customer order or indication of interest was received; and
- ▶ the terms of the unsolicited customer order or indication of interest that is the subject of the quotation (*e.g.*, security name and symbol, size, side of the market, the duration (if specified) and, if priced, the price).

To the extent a firm is displaying a quote representing an unsolicited customer order or indication of interest that was received from another broker-dealer, the firm is still required to create a contemporaneous record of:

- ▶ the identity of the person from whom information regarding the unsolicited customer order or indication of interest was received, if applicable;⁴
- ▶ the date and time the unsolicited customer order or indication of interest was received by the firm displaying the quotation; and
- ▶ the terms of the unsolicited customer order or indication of interest that is the subject of the quotation (*e.g.*, security name and symbol, size, side of the market, the duration (if specified) and, if priced, the price).

The firm displaying the unsolicited customer order or indication of interest may rely on the information provided by the routing firm if the member firm has a reasonable basis for believing that the information is valid.⁵

In addition, FINRA has amended Rule 6540 (Requirements Applicable to Market Makers) to delete footnote #1. Formerly, footnote #1 provided a summary of exemptive relief granted by the SEC from the requirements of SEA Rule 15c2-11 (subject to certain conditions). However, given that the SEC has since granted additional exemptive requests from the requirements of SEA Rule 15c2-11 that were not included in footnote #1 (and may continue to grant further requests in the future), FINRA deleted footnote #1 in its entirety and has instead specified in Rule 6540 that members must demonstrate compliance with (or qualify for an exception or *exemption* from) SEA Rule 15c2-11.⁶

Endnotes

- 1 SEA Rule 15c2-11 defines “quotation” as any bid or offer at a specified price with respect to a security, or any indication of interest by a broker or dealer in receiving bids or offers from others for a security, or any indication by a broker or dealer that advertises its general interest in buying or selling a particular security.
- 2 SEA Rule 15c2-11 defines “quotation medium” as any “inter-dealer quotation system” or any publication or electronic communications network or other device that is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell. “Inter-dealer quotation system” means any system of general circulation to brokers or dealers that regularly disseminates the quotations of identified brokers or dealers.
- 3 In cases where a firm is displaying a quote representing an unsolicited customer order or indication of interest that was received electronically, it is understood that there may not be a “person” associated with the receipt or submission of such unsolicited customer order or indication of interest. Thus, with respect to the requirement that firms record (1) the identity of the associated person who received the unsolicited customer order or indication of interest; or (2) the identity of the person from whom information regarding the unsolicited customer order or indication of interest was received where the unsolicited customer order or indication of interest is received from another broker-dealer, firms are only required to record such information if applicable.
- 4 *Id.*

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Endnotes continued

- 5 It is critical that the firm receiving an unsolicited customer order or indication of interest be advised of and understand the terms of the order or indication of interest that are relevant to the exception so that the receiving member firm may reasonably and accurately rely on the unsolicited customer order exception. For example, if the customer order is a “day” order, the receiving member firm must be advised of that fact so that it can withdraw the quote upon the expiration of the order. Similarly, to the extent that the terms of the unsolicited customer order or indication of interest change or other significant information is received by the firm routing the order (*e.g.*, a “good-till-cancelled” order is cancelled or there is a change in the terms of the order), the firm routing such order must promptly update the member firm displaying the quote as to the change in the terms of the order. To the extent the firm routing the unsolicited customer order or indication of interest is not a member firm, the member firm should make periodic inquiry as to whether the terms of the order have changed. Member firms may not rely on the unsolicited customer order exception where a displayed quote no longer accurately represents current unsolicited customer interest.
- 6 SEA Rule 15c2-11(h) sets forth the SEC’s exemptive authority with respect to the requirements of SEA Rule 15c2-11 and provides that SEA Rule 15c2-11 shall not prohibit any publication or submission of any quotation if the SEC, upon written request or upon its own motion, exempts such quotation either unconditionally or on specified terms and conditions, as not constituting a fraudulent, manipulative or deceptive practice comprehended within the purpose of the rule.