Regulatory Notice 11-29

June 2011

New Issue Allocations and Distributions

Frequently Asked Questions on Market Orders and Delayed Implementation Date for FINRA Rule 5131(b) and (d)(4)

Executive Summary

FINRA Rule 5131 sets forth detailed regulatory requirements for the allocation of new issues.[1] This *Notice* announces a new implementation date of September 26, 2011, for the provisions under Rule 5131 that govern spinning and market orders[2] and provides interpretive guidance concerning the acceptance of market orders.

The text of the rule can be found in the online *FINRA Manual*.

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

Background and Discussion

In *Regulatory Notice 10-60*, FINRA announced SEC approval of new FINRA Rule 5131 to address abuses in the allocation and distribution of new issues.

Paragraph (b) of the rule (Spinning) implements a recommendation from the IPO Advisory Committee Report to prohibit spinning—*i.e.,* an underwriter's allocation of IPO shares to directors or executives of investment banking clients in exchange for receipt of investment banking business. Paragraph (d)(4) of the rule (Market Orders) prohibits firms from accepting any 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. The implementation date of both of these provisions has been extended to September 26, 2011. All other provisions of Rule 5131 became effective on May 27, 2011.

Notice Type
- Guidance

Suggested Routing
- Compliance
- Legal
- Systems
- Trading and Market Making
- Training

Key Topics
- Allocations
- Initial Public Offerings
- Investment Banking
- Market Orders
- New Issues
- NMS Stocks
- OTC Equity Securities
- Spinning

Referenced Rules
- FINRA Rule 2010
- FINRA Rule 5130
- FINRA Rule 5131
- NASD Rule 2320
- Regulatory Notice 10-60

Financial Industry Regulatory Authority

As discussed in *Regulatory Notice 10-60*, the market orders provision addresses the inherent volatility of a new issue as it commences trading in the public markets, and the potential for a wide variance between the public offering price of the new issue and the price at which trading in the secondary market commences. As a result, investors who place market orders for a new issue may find their orders filled at prices beyond their reasonable expectations, and such transactions may further contribute to the unconstrained increase in the price of a new issue in the secondary market.

FINRA has received several interpretive questions concerning the market orders provision and, to facilitate member firm compliance, FINRA staff has set forth the following guidance. For more information on Rule 5131, see rule filing SR-NASD-2003-140.

Frequently Asked Questions

Q1: Does the market orders provision of Rule 5131 apply to both OTC Equity Securities and NMS Stocks?

A1: Yes. The market orders provision of Rule 5131 applies to shares of a "new issue." Rule 5130(i)(9), which is referenced in the definitions of Rule 5131, defines "new issue" to mean "any initial public offering of an equity security as defined in Section 3(a)(11) of the Exchange Act, made pursuant to a registration statement or offering circular," with enumerated exceptions, and does not restrict its scope to either NMS Stocks or OTC Equity Securities.

Q2: Rule 5131(d)(4) prohibits the acceptance of market orders 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. What constitutes *commencement of trading* for the purposes of this provision?

A2: For the purposes of the market orders provision, the *commencement of trading* in the secondary market of shares of a new issue that is an NMS Stock would be evidenced by the first trade on the national securities exchange listing the security, as indicated by the dissemination of an opening transaction in the security by that exchange. For OTC Equity Securities, *commencement of trading* in the secondary market would be evidenced by the first regular way, disseminated trade reported to the OTC Reporting Facility during normal market hours.

Q3: Does Rule 5131(d)(4) apply to "not held" orders?

A3: Generally, a "not held" order is an unpriced, discretionary order voluntarily categorized as such by the customer and with respect to which the customer has granted the firm price and time discretion. As such, "not held" orders are not considered "market orders" for the purposes of Rule 5131(d)(4).[3]

Q4: Does the prohibition on market orders apply only to inbound customer orders?

A4: Rule 5131(d)(4) applies to the acceptance of any market order, whether from a customer of the firm, a customer of another broker-dealer or another broker-dealer. However, priced orders, such as limit orders, are not subject to the prohibition.

Q5: Does the prohibition on market orders extend to proprietary trading?

A5: As noted above, the market order prohibition applies to the acceptance of any market order, including a proprietary market order from another broker-dealer. Therefore, if a member firm were to route its proprietary market order in a new issue to another member firm, that other firm would be prohibited from accepting the market order. To the extent a firm sends its market order *directly* to an exchange and such order is not otherwise "accepted" by a firm, it would not be prohibited by this rule.

Q6. Does a member firm need to reject a market order at the time it is first received, or can the firm reject an order previously accepted as long as it does so prior to executing the order or routing the order to another broker-dealer or an exchange?

A6. For purposes of compliance with Rule 5131(d)(4), a firm may reject a market order for a new issue at any point within its order management system prior to executing or routing the order. If a firm rejects a previously accepted customer order that is OATS reportable, it must indicate in its OATS report that the firm, not the customer, cancelled the order.

Endnotes

1. *See* Securities Exchange Act Release No. 63010 (September 29, 2010), 75 FR 61541 (October 5, 2010) (Order Approving File No. SR-NASD-2003-140).
2. *See* Securities Exchange Act Release No. 64512 (May 18, 2011), 76 FR 29808 (May 23, 2011) (Order Approving File No. SR-FINRA-2011-017).
3. This does not alter other firm obligations with respect to the handling of customer orders, including "not held" orders (*see e.g.,* FINRA Rule 2010 and NASD Rule 2320).