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> [FINRA RULES](#) > [2000. DUTIES AND CONFLICTS](#)

## 2010. STANDARDS OF COMMERCIAL HONOR AND PRINCIPLES OF TRADE

The Rule

Notices

A member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.

### Cross References-

[1122, Filing of Misleading Information as to Membership or Registration](#)

[2111, Suitability](#)

[2121.01, Mark-Up Policy](#)

[2342, "Breakpoint" Sales](#)

[5130, Restrictions on the Purchase and Sale of Initial Equity Public Offerings](#)

[5210, Publication of Transactions and Quotations](#)

[5220, Offers at stated Prices](#)

[5270, Front Running of Block Transactions](#)

[5320, Prohibition Against Trading Ahead of Customer Orders](#)

[IM-10100, Failure to Act Under Provisions of Code of Arbitration Procedure](#)

[11111, Refusal to Abide by Rulings of the Committee](#)

[IM-12000, Failure to Act Under Provisions of Code of Arbitration Procedure for Customer Disputes](#)

[IM-13000, Failure to Act Under Provisions of Code of Arbitration Procedure for Industry Disputes](#)

Amended by SR-FINRA-2008-028 eff. Dec. 15, 2008.

Amended by SR-NASD-2005-087 eff. Aug. 1, 2006

**Selected Notices:** [96-44](#), [08-57](#).

< [2000. DUTIES AND CONFLICTS](#)

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[2020. USE OF MANIPULATIVE, DECEPTIVE OR OTHER FRAUDULENT DEVICES](#) >

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## 2020. Use of Manipulative, Deceptive or Other Fraudulent Devices

The Rule

Notices

No 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.

### ***Cross References-***

*2111, Suitability*

*5210, Publication of Transactions and Quotations*

Amended by SR-FINRA-2008-028 eff. Dec. 15, 2008.

**Selected Notice:** 08-57.

[< 2010. STANDARDS OF COMMERCIAL HONOR AND PRINCIPLES OF TRADE](#)

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[2030. ENGAGING IN DISTRIBUTION AND SOLICITATION ACTIVITIES WITH GOVERNMENT ENTITIES >](#)

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## 2030. Engaging in Distribution and Solicitation Activities with Government Entities

### (a) Limitation on Distribution and Solicitation Activities

No covered member shall engage in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser that provides or is seeking to provide investment advisory services to such government entity within two years after a contribution to an official of the government entity is made by the covered member or a covered associate (including a person who becomes a covered associate within two years after the contribution is made).

### (b) Prohibition on Soliciting and Coordinating Contributions

No covered member or covered associate may solicit or coordinate any person or political action committee to make any:

(1) Contribution to an official of a government entity in respect of which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser; or

(2) Payment to a political party of a state or locality of a government entity with which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser.

### (c) Exceptions

#### (1) De minimis Exception

Paragraph (a) shall not apply to contributions made by a covered associate that is a natural person, to officials for whom the covered associate was entitled to vote at the time of the contributions and which in the aggregate do not exceed \$350 to any one official, per election, or to officials for whom the covered associate was not entitled to vote at the time of the contributions and which in the aggregate do not exceed \$150 to any one official, per election.

#### (2) Exception for Certain New Covered Associates

The prohibitions of paragraph (a) shall not apply to a covered member as a result of a contribution made by a natural person more than six months prior to becoming a covered associate of the covered member unless such person, after becoming a covered associate, engages in, or seeks to engage in, distribution or solicitation activities with a government entity on behalf of the covered member.

#### (3) Exception for Certain Returned Contributions

(A) A covered member that is prohibited from engaging in distribution or solicitation activities with a government entity pursuant to paragraph (a) as a result of a contribution made by a covered associate is excepted from such prohibition, subject to subparagraphs (B) and (C) below, upon satisfaction of the following requirements:

(i) The covered member must have discovered the contribution that resulted in the prohibition within four months of the date of such contribution;

(ii) Such contribution must not have exceeded \$350; and

(iii) The contributor must obtain a return of the contribution within 60 calendar days of the date of discovery of such contribution by the covered member.

(B) In any calendar year, a covered member that has reported on its annual Schedule I to Form X-17A-5 that it has more than 150 registered persons is entitled to no more than three exceptions pursuant to subparagraph (A), and a covered member that has reported on its annual Schedule I to Form X-17A-5 that it has 150 or fewer registered persons is entitled to no more than two exceptions pursuant to subparagraph (A).

(C) A covered member may not rely on the exception provided in subparagraph (A) more than once with respect to contributions by the same covered associate of the covered member regardless of time period.

### (d) Prohibitions as Applied to Covered Investment Pools

For purposes of this Rule:

(1) A covered member that engages in distribution or solicitation activities with a government entity on behalf of a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though that covered member was engaging in or seeking to engage in distribution or solicitation activities with the government entity on behalf of the investment adviser to the covered investment pool directly; and

(2) An investment adviser to a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government entity.

#### **(e) Further Prohibitions**

It shall be a violation of this Rule for any covered member or any of its covered associates to do anything indirectly that, if done directly, would result in a violation of this Rule.

#### **(f) Exemptions**

FINRA, upon application, may conditionally or unconditionally exempt a covered member from the prohibition described in paragraph (a). In determining whether to grant an exemption, FINRA shall consider, among other factors:

(1) Whether the exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this Rule;

(2) Whether the covered member:

(A) Before the contribution resulting in the prohibition was made, adopted and implemented policies and procedures reasonably designed to prevent violations of this Rule;

(B) Prior to or at the time the contribution that resulted in such prohibition was made, had no actual knowledge of the contribution; and

(C) After learning of the contribution:

(i) Has taken all available steps to cause the contributor involved in making the contribution that resulted in such prohibition to obtain a return of the contribution; and

(ii) Has taken such other remedial or preventive measures as may be appropriate under the circumstances;

(3) Whether, at the time of the contribution, the contributor was a covered associate or otherwise an associated person of the covered member, or was seeking to become an associated person, or covered associate of the covered member;

(4) The timing and amount of the contribution that resulted in the prohibition;

(5) The nature of the election (e.g., federal, state or local); and

(6) The contributor's apparent intent or motive in making the contribution that resulted in the prohibition, as evidenced by the facts and circumstances surrounding such contribution.

#### **(g) Definitions**

For purposes of this Rule:

(1) "Contribution" means any gift, subscription, loan, advance, or deposit of money or anything of value made for:

(A) The purpose of influencing any election for federal, state or local office;

(B) Payment of debt incurred in connection with any such election; or

(C) Transition or inaugural expenses of the successful candidate for state or local office.

(2) "Covered associate" means:

(A) Any general partner, managing member or executive officer of a covered member, or other individual with a similar status or function;

(B) Any associated person of a covered member who engages in distribution or solicitation activities with a government entity for such covered member;

(C) Any associated person of a covered member who supervises, directly or indirectly, the government entity distribution or solicitation activities of a person in subparagraph (B) above; and

(D) Any political action committee controlled by a covered member or a covered associate.

(3) "Covered investment pool" means:

(A) Any investment company registered under the Investment Company Act that is an investment option of a plan or program of a government entity; or

(B) Any company that would be an investment company under Section 3(a) of the Investment Company Act but for the exclusion provided from that definition by either Section 3(c)(1), 3(c)(7) or 3(c)(11) of that Act.

(4) "Covered member" means any member except when that member is engaging in activities that would cause the member to be a municipal advisor as defined in Exchange Act Section 15B(e)(4), SEA Rule 15Ba1-1(d)(1) through (4) and other rules and regulations thereunder;

(5) "Executive officer of a covered member" means:

(A) The president;

(B) Any vice president in charge of a principal business unit, division or function (such as sales, administration or finance);

(C) Any other officer of the covered member who performs a policy-making function; or

(D) Any other person who performs similar policy-making functions for the covered member.

(6) "Government entity" means any state or political subdivision of a state, including:

(A) Any agency, authority or instrumentality of the state or political subdivision;

(B) A pool of assets sponsored or established by the state or political subdivision or any agency, authority or instrumentality thereof, including but not limited to a defined benefit plan as defined in Section 414(j) of the Internal Revenue Code, or a state general fund;

(C) A plan or program of a government entity; and

(D) Officers, agents or employees of the state or political subdivision or any agency, authority or instrumentality thereof, acting in their official capacity.

(7) "Investment adviser" means any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under Section 203(b)(3) of the Investment Advisers Act, or that is an exempt reporting adviser, as defined in Rule 204-4(a) of that Act.

(8) "Official" means any person (including any election committee for the person) who was, at the time of the contribution, an incumbent, candidate or successful candidate for elective office of a government entity, if the office:

(A) Is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity; or

(B) Has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity.

(9) "Payment" means any gift, subscription, loan, advance or deposit of money or anything of value.

(10) "Plan or program of a government entity" means any participant-directed investment program or plan sponsored or established by a state or political subdivision or any agency, authority or instrumentality thereof, including but not limited to a qualified tuition plan authorized by Section 529 of the Internal Revenue Code, a retirement plan authorized by Section 403(b) or 457 of the Internal Revenue Code, or any similar program or plan.

(11) "Solicit" means:

(A) With respect to investment advisory services, to communicate, directly or indirectly, for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser; and

(B) With respect to a contribution or payment, to communicate, directly or indirectly, for the purpose of obtaining or arranging a contribution or payment.

Adopted by SR-FINRA-2015-056 eff. Aug. 20, 2017.

**Selected Notice:** 16-40

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## 2040. Payments to Unregistered Persons

### (a) General

No member or associated person shall, directly or indirectly, pay any compensation, fees, concessions, discounts, commissions or other allowances to:

(1) any person that is not registered as a broker-dealer under Section 15(a) of the Exchange Act but, by reason of receipt of any such payments and the activities related thereto, is required to be so registered under applicable federal securities laws and SEA rules and regulations; or

(2) any appropriately registered associated person unless such payment complies with all applicable federal securities laws, FINRA rules and SEA rules and regulations.

### (b) Retiring Representatives

(1) A member may pay continuing commissions to a retiring registered representative of the member, after he or she ceases to be associated with such member, that are derived from accounts held for continuing customers of the retiring registered representative regardless of whether customer funds or securities are added to the accounts during the period of retirement, provided that:

(A) a bona fide contract between the member and the retiring registered representative providing for the payments was entered into in good faith while the person was a registered representative of the member and such contract, among other things, prohibits the retiring registered representative from soliciting new business, opening new accounts, or servicing the accounts generating the continuing commission payments; and

(B) the arrangement complies with applicable federal securities laws, SEA rules and regulations.

(2) The term "retiring registered representative," as used in this Rule shall mean an individual who retires from a member (including as a result of a total disability) and leaves the securities industry. In the case of death of the retiring registered representative, the retiring registered representative's beneficiary designated in the written contract or the retiring registered representative's estate if no beneficiary is so designated may be the beneficiary of the respective member's agreement with the deceased representative.

### (c) Nonregistered Foreign Finders

A member may pay to a nonregistered foreign person (the "finder") transaction-related compensation based upon the business of customers the finder directs to the member if the following conditions are met:

(1) the member has assured itself that the finder who will receive the compensation is not required to register in the United States as a broker-dealer nor is subject to a disqualification as defined in Article III, Section 4 of FINRA's By-Laws, and has further assured itself that the compensation arrangement does not violate applicable foreign law;

(2) the finder is a foreign national (not a U.S. citizen) or foreign entity domiciled abroad;

(3) the customers are foreign nationals (not U.S. citizens) or foreign entities domiciled abroad transacting business in either foreign or U.S. securities;

(4) customers receive a descriptive document, similar to that required by Rule 206(4)-3(b) of the Investment Advisers Act, that discloses what compensation is being paid to finders;

(5) customers provide written acknowledgment to the member of the existence of the compensation arrangement and such acknowledgment is retained and made available for inspection by FINRA;

(6) records reflecting payments to finders are maintained on the member's books, and actual agreements between the member and the finder are available for inspection by FINRA; and

(7) the confirmation of each transaction indicates that a referral or finders fee is being paid pursuant to an agreement.

••• Supplementary Material: -----

**.01 Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act.** For purposes of Rule 2040, FINRA expects members to determine that their proposed activities would not require the recipient of the payments to register as a broker-dealer and to reasonably support such determination. Members that are uncertain as to whether an unregistered person may be required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member can derive support for their determination by, among other things, (1) reasonably relying on previously published releases, no-action letters or interpretations from the Commission or Commission staff that apply to their facts and circumstances; (2) seeking a no-action letter from the Commission staff; or (3) obtaining a legal opinion from independent, reputable U.S. licensed counsel knowledgeable in the area. The member's determination must be reasonable under the circumstances and should be reviewed periodically if payments to the unregistered person are ongoing in nature. In addition, a member must maintain books and records that reflect the member's determination.

Amended by SR-FINRA-2014-037 eff. Aug. 24, 2015.  
Adopted by SR-NASD-94-51 eff. Feb. 15, 1995 (Paragraph (c)).

**Selected Notices:** 95-37, 15-07.

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## 2060. Use of Information Obtained in Fiduciary Capacity

The Rule

Notices

A member who in the capacity of paying agent, transfer agent, trustee, or in any other similar capacity, has received information as to the ownership of securities, shall under no circumstances make use of such information for the purpose of soliciting purchases, sales or exchanges except at the request and on behalf of the issuer.

### ***Cross Reference–***

*Rule 2150. Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts*

Amended by SR-FINRA-2009-067 eff. Feb. 15, 2010.

**Selected Notice:** 09-72.

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[2070. TRANSACTIONS INVOLVING FINRA EMPLOYEES →](#)

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## 2070. Transactions Involving FINRA Employees

The Rule

Notices

(a) When a member has actual notice that a FINRA employee has a financial interest in, or controls trading in, an account, the member shall promptly obtain and implement an instruction from the employee directing the member to provide duplicate account statements to FINRA.

(b) Members shall not directly or indirectly make any loan of money or securities to any FINRA employee. However, this prohibition does not apply to loans made in the context of disclosed, routine banking and brokerage agreements, or loans that are clearly motivated by a personal or family relationship.

(c) Notwithstanding the annual dollar limitation set forth in Rule 3220(a), members shall not directly or indirectly give, or permit to be given, anything above nominal value to any FINRA employee who has responsibility for a regulatory matter involving the member. For purposes of this paragraph, the term "regulatory matter" includes, but is not limited to, examinations, disciplinary proceedings, membership applications and dispute-resolution proceedings.

Amended by SR-FINRA-2008-027 eff. Dec. 15, 2008.

Adopted by SR-NASD-00-58 eff. Nov. 17, 2000.

**Selected Notice:** 08-57.

[← 2060. USE OF INFORMATION OBTAINED IN FIDUCIARY CAPACITY](#)

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[2080. OBTAINING AN ORDER OF EXPUNGEMENT OF CUSTOMER DISPUTE INFORMATION FROM THE CENTRAL REGISTRATION DEPOSITORY \(CRD\) SYSTEM →](#)

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## 2080. Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD) System

[The Rule](#)[Notices](#)

(a) Members or associated persons seeking to expunge information from the CRD system arising from disputes with customers must obtain an order from a court of competent jurisdiction directing such expungement or confirming an arbitration award containing expungement relief.

(b) Members or associated persons petitioning a court for expungement relief or seeking judicial confirmation of an arbitration award containing expungement relief must name FINRA as an additional party and serve FINRA with all appropriate documents unless this requirement is waived pursuant to subparagraph (1) or (2) below.

(1) Upon request, FINRA may waive the obligation to name FINRA as a party if FINRA determines that the expungement relief is based on affirmative judicial or arbitral findings that:

(A) the claim, allegation or information is factually impossible or clearly erroneous;

(B) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation or conversion of funds; or

(C) the claim, allegation or information is false.

(2) If the expungement relief is based on judicial or arbitral findings other than those described above, FINRA, in its sole discretion and under extraordinary circumstances, also may waive the obligation to name FINRA as a party if it determines that:

(A) the expungement relief and accompanying findings on which it is based are meritorious; and

(B) the expungement would have no material adverse effect on investor protection, the integrity of the CRD system or regulatory requirements.

(c) For purposes of this Rule, the terms "sales practice violation," "investment-related," and "involved" shall have the meanings set forth in the Uniform Application for Securities Industry Registration or Transfer ("Form U4") in effect at the time of issuance of the subject expungement order.

Amended by SR-FINRA-2009-016 eff. Aug. 17, 2009.

Amended by SR-NASD-2003-200 eff. April 12, 2004.

Adopted by SR-NASD-2002-168 eff. April 12, 2004.

**Selected Notice:** 04-16, 09-33.



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## 2081. Prohibited Conditions Relating to Expungement of Customer Dispute

No member or associated person shall condition or seek to condition settlement of a dispute with a customer on, or to otherwise compensate the customer for, the customer's agreement to consent to, or not to oppose, the member's or associated person's request to expunge such customer dispute information from the CRD system.

Adopted by SR-FINRA-2014-020 eff. July 30, 2014.

**Selected Notice:** 14-31

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[< 2080. OBTAINING AN ORDER OF EXPUNGEMENT OF CUSTOMER DISPUTE INFORMATION FROM THE CENTRAL REGISTRATION DEPOSITORY \(CRD\) SYSTEM](#)

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[2090. KNOW YOUR CUSTOMER >](#)

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## 2090. Know Your Customer

The Rule

Notices

Every member shall use reasonable diligence, in regard to the opening and maintenance of every account, to know (and retain) the essential facts concerning every customer and concerning the authority of each person acting on behalf of such customer.

### ••• Supplementary Material: -----

**.01 Essential Facts.** For purposes of this Rule, facts "essential" to "knowing the customer" are those required to (a) effectively service the customer's account, (b) act in accordance with any special handling instructions for the account, (c) understand the authority of each person acting on behalf of the customer, and (d) comply with applicable laws, regulations, and rules.

Adopted by SR-FINRA-2010-039 and amended by SR-FINRA-2011-016 eff. July 9, 2012.

**Selected Notices:** 11-02, 11-25, 12-25.

< 2081. PROHIBITED CONDITIONS RELATING TO EXPUNGEMENT OF CUSTOMER

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DISPUTE

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## 2111. Suitability

[The Rule](#)[Notices](#)

(a) A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.

(b) A member or associated person fulfills the customer-specific suitability obligation for an institutional account, as defined in Rule 4512(c), if (1) the member or associated person has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the member's or associated person's recommendations. Where an institutional customer has delegated decisionmaking authority to an agent, such as an investment adviser or a bank trust department, these factors shall be applied to the agent.

### ••• Supplementary Material: -----

**.01 General Principles.** Implicit in all member and associated person relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of FINRA rules, with particular emphasis on the requirement to deal fairly with the public. The suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct.

**.02 Disclaimers.** A member or associated person cannot disclaim any responsibilities under the suitability rule.

**.03 Recommended Strategies.** The phrase "investment strategy involving a security or securities" used in this Rule is to be interpreted broadly and would include, among other things, an explicit recommendation to hold a security or securities. However, the following communications are excluded from the coverage of Rule 2111 as long as they do not include (standing alone or in combination with other communications) a recommendation of a particular security or securities:

(a) General financial and investment information, including (i) basic investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment, (ii) historic differences in the return of asset classes (e.g., equities, bonds, or cash) based on standard market indices, (iii) effects of inflation, (iv) estimates of future retirement income needs, and (v) assessment of a customer's investment profile;

(b) Descriptive information about an employer-sponsored retirement or benefit plan, participation in the plan, the benefits of plan participation, and the investment options available under the plan;

(c) Asset allocation models that are (i) based on generally accepted investment theory, (ii) accompanied by disclosures of all material facts and assumptions that may affect a reasonable investor's assessment of the asset allocation model or any report generated by such model, and (iii) in compliance with Rule 2214 (Requirements for the Use of Investment Analysis Tools) if the asset allocation model is an "investment analysis tool" covered by Rule 2214; and

(d) Interactive investment materials that incorporate the above.

**.04 Customer's Investment Profile.** A member or associated person shall make a recommendation covered by this Rule only if, among other things, the member or associated person has sufficient information about the customer to have a reasonable basis to believe that the recommendation is suitable for that customer. The factors delineated in Rule 2111(a) regarding a customer's investment profile generally are relevant to a determination regarding whether a recommendation is suitable for a particular customer, although the level of importance of each factor may vary depending on the facts and circumstances of the particular case. A member or associated person shall use reasonable diligence to obtain and analyze all of the factors delineated in Rule 2111(a) unless the member or associated person has a reasonable basis to believe, documented with specificity, that one or more of the factors are not relevant components of a customer's investment profile in light of the facts and circumstances of the particular case.

**.05 Components of Suitability Obligations.** Rule 2111 is composed of three main obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability.

(a) The reasonable-basis obligation requires a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least *some* investors. In general, what constitutes reasonable diligence will vary depending on, among other things, the complexity of and risks associated with the security or investment strategy and the member's or associated person's familiarity with the security or investment strategy. A member's or associated person's reasonable diligence must provide the member or associated person with an understanding of the potential risks and rewards associated with the recommended security or strategy. The lack of such an understanding when recommending a security or strategy violates the suitability rule.

(b) The customer-specific obligation requires that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile, as delineated in Rule 2111(a).

(c) Quantitative suitability requires a member or associated person to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Rule 2111(a). No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a member or associated person has violated the quantitative suitability obligation.

**.06 Customer's Financial Ability.** Rule 2111 prohibits a member or associated person from recommending a transaction or investment strategy involving a security or securities or the continuing purchase of a security or securities or use of an investment strategy involving a security or securities unless the member or associated person has a reasonable basis to believe that the customer has the financial ability to meet such a commitment.

**.07 Institutional Investor Exemption.** Rule 2111(b) provides an exemption to customer-specific suitability regarding institutional investors if the conditions delineated in that paragraph are satisfied. With respect to having to indicate affirmatively that it is exercising independent judgment in evaluating the member's or associated person's recommendations, an institutional customer may indicate that it is exercising independent judgment on a trade-by-trade basis, on an asset-class-by-asset-class basis, or in terms of all potential transactions for its account.

**.08 Regulation Best Interest.** This Rule shall not apply to recommendations subject to SEA Rule 15l-1 ("Regulation Best Interest").

Amended by SR-FINRA-2020-007 eff. June 30, 2020.

Amended by SR-FINRA-2014-016 eff. May 1, 2014.

Amended by SR-FINRA-2013-001 eff. Feb. 4, 2013.

Adopted by SR-FINRA-2010-039 and amended by SR-FINRA-2011-016 and SR-FINRA-2012-027 eff. July 9, 2012.

**Selected Notices:** 11-02, 11-25, 12-25, 12-55, 20-18.

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2114. RECOMMENDATIONS TO CUSTOMERS IN OTC EQUITY SECURITIES →

#### VERSIONS

Jun 30, 2020 onwards

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## 2114. Recommendations to Customers in OTC Equity Securities

The Rule

Notices

Preliminary Note: The requirements of this Rule are in addition to other existing member obligations under FINRA rules and the federal securities laws, including obligations to determine suitability of particular securities transactions with customers and to have a reasonable basis for any recommendation made to a customer. This Rule is not intended to act or operate as a presumption or as a safe harbor for purposes of determining suitability or for any other legal obligation or requirement imposed under FINRA rules and the federal securities laws.

### (a) Review Requirement

No member or person associated with a member shall recommend that a customer purchase or sell short any OTC Equity Security, unless the member has reviewed the current financial statements of the issuer, current material business information about the issuer, and made a determination that such information, and any other information available, provides a reasonable basis under the circumstances for making the recommendation.

### (b) Definitions

(1) For purposes of this Rule, the term "current financial statements" shall include:

(A) For issuers that are not foreign private issuers,

(i) a balance sheet as of a date less than 15 months before the date of the recommendation;

(ii) a statement of profit and loss for the 12 months preceding the date of the balance sheet;

(iii) if the balance sheet is not as of a date less than 6 months before the date of the recommendation, additional statements of profit and loss for the period from the date of the balance sheet to a date less than 6 months before the date of the recommendation;

(iv) publicly available financial statements and other financial reports filed during the 12 months preceding the date of the recommendation and up to the date of the recommendation with the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the SEC, foreign regulatory authorities, and bank and insurance regulators; and

(v) all publicly available financial information filed with the SEC during the 12 months preceding the date of the recommendation contained in registration statements or SEC Regulation A filings.

(B) For foreign private issuers,

(i) a balance sheet as of a date less than 18 months before the date of the recommendation;

(ii) a statement of profit and loss for the 12 months preceding the date of the balance sheet;

(iii) if the balance sheet is not as of a date less than 9 months before the date of the recommendation, additional statements of profit and loss for the period from the date of the balance sheet to a date less than 9 months before the date of the recommendation, if any such statements have been prepared by the issuer; and

(iv) publicly available financial statements and other financial reports filed during the 12 months preceding the date of the recommendation and up to the date of the recommendation with the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the SEC, foreign regulatory authorities, and bank and insurance regulators.

(2) For purposes of this Rule, the term "current material business information" shall include information that is ascertainable through the reasonable exercise of professional diligence and that a reasonable person would take into account in reaching an investment decision.

(3) For purposes of this Rule, the term "OTC Equity Security" shall have the meaning described in Rule 6420.

### (c) Compliance Requirements

(1) A member shall designate a registered person to conduct the review required by this Rule. In making such designation, the member must ensure that:



(A) Either the person is registered as a General Securities Principal or General Securities Sales Supervisor, or the designated person's conduct in complying with the provisions of this Rule is appropriately supervised by a General Securities Principal or General Securities Sales Supervisor; and

(B) Such designated person has the requisite skills, background and knowledge to conduct the review required under this Rule.

(2) The member shall document the information reviewed, the date of the review, and the name of the person performing the review of the required information. In the event that the person designated to perform the review is not registered as a General Securities Principal or General Securities Sales Supervisor, the member shall also document the name of the General Securities Principal or General Securities Sales Supervisor who supervised the designated person.

#### **(d) Additional Review Requirement for Delinquent Filers**

If an issuer has not made current filings required by the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the SEC, foreign regulatory authorities, or bank and insurance regulators, such review must include an inquiry into the circumstances concerning the failure to make current filings, and a determination, based on all the facts and circumstances, that the recommendation is appropriate under the circumstances. Such a determination must be made in writing and maintained by the member.

#### **(e) Exemptions**

(1) The requirements of this Rule shall not apply to:

(A) Transactions that meet the requirements of Rule 504 of SEC Regulation D and transactions with an issuer not involving any public offering pursuant to Section 4(2) of the Securities Act;

(B) Transactions with or for an account that qualifies as an "institutional account" under Rule 4512(c) or with a customer that is a "qualified institutional buyer" under Securities Act Rule 144A or "qualified purchaser" under Section 2(a)(51) of the Investment Company Act;

(C) Transactions in an issuer's securities if the issuer has at least \$50 million in total assets and \$10 million in shareholder's equity as stated in the issuer's most recent audited current financial statements, as defined in this Rule;

(D) Transactions in securities of a bank as defined in Section 3(a)(6) of the Exchange Act and/or insurance company subject to regulation by a state or federal bank or insurance regulatory authority; or

(E) A security that has a bid price, as published in a quotation medium, of at least \$50 per share. If the security is a unit composed of one or more securities, the bid price of the unit divided by the number of shares of the unit that are not warrants, options, rights, or similar securities must be at least \$50.

(2) Pursuant to the Rule 9600 Series, FINRA, for good cause shown after taking into consideration all relevant factors, may exempt any person, security or transaction, or any class or classes of persons, securities or transactions, either unconditionally or on specified terms, from any or all of the requirements of this Rule if it determines that such exemption is consistent with the purpose of this Rule, the protection of investors, and the public interest.

Amended by SR-FINRA-2011-065 eff. Dec. 5, 2011.

Amended by SR-FINRA-2008-055 and SR-FINRA-2009-033 eff. June 15, 2009.

Adopted by SR-NASD-99-04 eff. Oct. 30, 2002.

**Selected Notices:** 02-66, 09-20.

◀ 2111. SUITABILITY

UP

2120. COMMISSIONS, MARK UPS AND CHARGES ▶

#### **VERSIONS**

Dec 05, 2011 onwards

## 2121. Fair Prices and Commissions

The Rule

Notices

In securities transactions, whether in "listed" or "unlisted" securities, if a member buys for his own account from his customer, or sells for his own account to his customer, he shall buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit; and if he acts as agent for his customer in any such transaction, he shall not charge his customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market therefor.

### ••• Supplementary Material: -----

#### .01 Mark-Up Policy

The question of fair mark-ups or spreads is one which has been raised from the earliest days of the National Association of Securities Dealers ("Association"). No definitive answer can be given and no interpretation can be all-inclusive for the obvious reason that what might be considered fair in one transaction could be unfair in another transaction because of different circumstances. In 1943, the Association's Board adopted what has become known as the "5% Policy" to be applied to transactions executed for customers. It was based upon studies demonstrating that the large majority of customer transactions were effected at a mark-up of 5% or less. The Policy has been reviewed by the Board of Governors on numerous occasions and each time the Board has reaffirmed the philosophy expressed in 1943. Pursuant thereto, and in accordance with Article VII, Section 1(a)(ii) of the By-Laws, the Board adopted the following interpretation.

It shall be deemed a violation of Rule 2010 and Rule 2121 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission which is not reasonable.

#### (a) General Considerations

Since the adoption of the "5% Policy" the Board has determined that:

- (1) The "5% Policy" is a guide, not a rule.
- (2) A member may not justify mark-ups on the basis of expenses which are excessive.
- (3) The mark-up over the prevailing market price is the significant spread from the point of view of fairness of dealings with customers in principal transactions. In the absence of other bona fide evidence of the prevailing market, a member's own contemporaneous cost is the best indication of the prevailing market price of a security.
- (4) A mark-up pattern of 5% or even less may be considered unfair or unreasonable under the "5% Policy."
- (5) Determination of the fairness of mark-ups must be based on a consideration of all the relevant factors, of which the percentage of mark-up is only one.

#### (b) Relevant Factors

Some of the factors which the Board believes that members and the Association's committees should take into consideration in determining the fairness of a mark-up are as follows:

##### (1) The Type of Security Involved

Some securities customarily carry a higher mark-up than others. For example, a higher percentage of mark-up customarily applies to a common stock transaction than to a bond transaction of the same size. Likewise, a higher percentage applies to sales of units of direct participation programs and condominium securities than to sales of common stock.

##### (2) The Availability of the Security in the Market

In the case of an inactive security the effort and cost of buying or selling the security, or any other unusual circumstances connected with its acquisition or sale, may have a bearing on the amount of mark-up justified.

**(3) The Price of the Security**

While there is no direct correlation, the percentage of mark-up or rate of commission generally increases as the price of the security decreases. Even where the amount of money is substantial, transactions in lower priced securities may require more handling and expense and may warrant a wider spread.

**(4) The Amount of Money Involved in a Transaction**

A transaction which involves a small amount of money may warrant a higher percentage of mark-up to cover the expenses of handling.

**(5) Disclosure**

Any disclosure to the customer, before the transaction is effected, of information which would indicate (A) the amount of commission charged in an agency transaction or (B) mark-up made in a principal transaction is a factor to be considered. Disclosure itself, however, does not justify a commission or mark-up which is unfair or excessive in light of all other relevant circumstances.

**(6) The Pattern of Mark-Ups**

While each transaction must meet the test of fairness, the Board believes that particular attention should be given to the pattern of a member's mark-ups.

**(7) The Nature of the Member's Business**

The Board is aware of the differences in the services and facilities which are needed by, and provided for, customers of members. If not excessive, the cost of providing such services and facilities, particularly when they are of a continuing nature, may properly be considered in determining the fairness of a member's mark-ups.

**(c) Transactions to Which the Policy is Applicable**

The Policy applies to all securities, whether oil royalties or any other security, in the following types of transactions:

- (1) A transaction in which a member buys a security to fill an order for the same security previously received from a customer. This transaction would include the so-called "riskless" or "simultaneous" transaction.
- (2) A transaction in which the member sells a security to a customer from inventory. In such a case the amount of the mark-up would be determined on the basis of the mark-up over the bona fide representative current market. The amount of profit or loss to the member from market appreciation or depreciation before, or after, the date of the transaction with the customer would not ordinarily enter into the determination of the amount or fairness of the mark-up.
- (3) A transaction in which a member purchases a security from a customer. The price paid to the customer or the mark-down applied by the member must be reasonably related to the prevailing market price of the security.
- (4) A transaction in which the member acts as agent. In such a case, the commission charged the customer must be fair in light of all relevant circumstances.
- (5) Transactions wherein a customer sells securities to, or through, a broker/dealer, the proceeds from which are utilized to pay for other securities purchased from, or through, the broker/dealer at or about the same time. In such instances, the mark-up shall be computed in the same way as if the customer had purchased for cash and in computing the mark-up there shall be included any profit or commission realized by the dealer on the securities being liquidated, the proceeds of which are used to pay for securities being purchased.

**(d) Transactions to Which the Policy is Not Applicable**

The Mark-Up Policy is not applicable to the sale of securities where a prospectus or offering circular is required to be delivered and the securities are sold at the specific public offering price.

**.02 Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities<sup>1</sup>****(a) Scope**

Supplementary Material .01 to Rule 2121 applies to debt securities transactions, and this Supplementary Material .02 supplements the guidance provided in Supplementary Material .01.

**(b) Prevailing Market Price**

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. Presumptively for purposes of this Supplementary Material .02, the prevailing