NSCP
NATIONAL SOCIETY OF COMPLIANCE PROFESSIONALS INC.

December 17, 2008

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, D.C. 2006-1500

Re: Comments on Proposed Rule 2030

Dear Ms. Asquith:

The National Society of Compliance Professionals ("NSCP") appreciates the opportunity to comment on the proposed Rule 2030 ("Proposed Rule") by the Financial Industry Regulatory Authority ("FINRA").

The Proposed Rule is of considerable interest to NSCP and its members. NSCP is the largest organization in the securities industry serving compliance professionals exclusively through education, certification (CSCP), publications, consultation forums, and regulatory advocacy. Since its founding in 1987, NSCP membership has grown to over 1700 members including compliance professionals at broker-dealers, investment advisers, banks, insurance companies, and hedge funds. The diversity of our membership allows the NSCP to represent a large variety of perspectives in the financial services industry.

As an initial matter, NSCP commends FINRA for addressing the important problem of abusive practices relating to rumors. NSCP understands that recent market turmoil poses grave dangers to our economy and that efforts must be undertaken to address the root causes of this instability. Improper rumor mongering has been identified as a potential cause of market instability and this issue must be carefully considered, as FINRA has undertaken to do.

NSCP has three main concerns with the Proposed Rule:

1. The Proposed Rule, if adopted, would impose difficult and costly burdens on compliance professionals.

2. The Proposed Rule, if adopted, could impair the efficiency of the markets by interfering with the expression of legitimate opinions between market participants, and have the counterproductive effect of making it more difficult to quell false rumors.

3. The Proposed Rule's reporting obligations to FINRA are impractical and could lead to the diversion of scarce compliance and enforcement resources from more important areas.

Rather than adopting the Proposed Rule, NSCP favors an approach more akin to the one adopted in the UK by the Financial Services Authority ("FSA"). The FSA is also concerned about false or misleading rumors and has published a survey of industry best practices on how financial firms should approach and handle market rumors.[1]

I. Background

The spreading of false rumors has been prohibited for many years by the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers ("NASD").[2] The Proposed Rule would combine Rule 6140(e) and NYSE 435(5). The Proposed Rule would apply to all securities, would contain a broad reporting requirement, and would not contain NYSE 435(5)'s exception for unsubstantiated information published by widely circulated media.

Although the NYSE and NASD rules have been in place for many years, their implementation has been tempered by prosecutorial discretion. The Proposed Rule would not incorporate many key elements of that discretion. For example, while the handful of cases that have been brought for spreading false rumors have all involved situations in which the rumor was known by its disseminator to be false, the Proposed Rule would punish the dissemination of a rumor that the disseminator "has reasonable grounds for believing is false," and even a rumor that is believed to be true but "improperly influence[s] the market price of [a] security." In addition, the dissemination of false rumors has only been prosecuted when the rumor was material in the sense that it materially impacted the price of a security. The Proposed Rule would sanction the spreading of rumors, even if those rumors did not "improperly influence the market price of [a] security." Finally, and perhaps most important, the focus of prosecution has been on the source of the rumor, not simply on anyone who happens to innocently spread the rumor without an economic interest in the rumor's impact on the price of a security. The Proposed Rule would not

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[1] The FSA also included a case study demonstrating how quickly a rumor can spread, and the remedial actions the financial firms undertook after the FSA investigated. *See* FINANCIAL SERVICES AUTHORITY, MARKET WATCH, 2008, Issue No. 30, *available at* http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter30.pdf (last accessed Nov. 25, 2008)

[2] The dissemination of false rumors is prohibited by NYSE Rule 435(5) ("No member, member organization, or allied member therein shall: [c]irculate in any manner rumors of a sensational character which might reasonably be expected to affect market conditions on the Exchange. Discussion of unsubstantiated information published by a widely circulated public media is not prohibited when its source and unsubstantiated nature are also disclosed. Report shall be promptly made to the Exchange of any circumstance which gives reason to believe that any rumor or unsubstantiated information might have been originated or circulated for the purpose of influencing prices in listed securities.") and FINRA Rule 6140(e)("No member shall make any statement or circulate and disseminate any information concerning any designated security which such member knows or has reasonable grounds for believing is false or misleading or would improperly influence the market price of such security.").

simply prohibit someone from being the source of a rumor, it would prohibit anyone from "circulating" that rumor as well.

By failing to codify these important elements of prosecutorial discretion, the Proposed Rule threatens to reach far more broadly than any previous enforcement action to conduct that is innocent, harmless, and commonplace. For example, innocent discussion of opinions that are clearly identified as unsubstantiated could be punished under the Proposed Rule.

II. The Proposed Rule Would Impose Severe Compliance Burdens

NSCP's members are concerned that the Proposed Rule would impose exceptional, if not impossible, burdens on compliance professionals. Whenever a new rule is adopted, NSCP's members are called upon to develop policies and procedures, systems of surveillance and testing, and supervisory arrangements to assist member firms in complying with the new rule. If the Proposed Rule is adopted, NSCP's members would be asked to assume this role with respect to the Proposed Rule. As noted below, this would impose significant technical and man hour obligations on compliance professionals.

Since every casual expression of opinion, no matter how innocent and no matter how unlikely to influence the price of a security, could qualify as a rumor under the Proposed Rule, NSCP members would face an exceptional compliance challenge in implementing the Proposed Rule. Today, communications between firm representatives and others are reviewed and controlled for key types of communications, such as recommendations and advertising. A broad prohibition against innocent expressions of opinion would force compliance professionals to control and monitor virtually every communication by the firm's representatives. We agree with the FSA's recent observation that "[c]omprehensive monitoring of staff communications is neither practical nor cost effective."

Inevitably, this compliance burden would consume scarce resources and diminish surveillance of other, more important, areas. We do note that FINRA has asked for comment on whether "Rule 2030 should provide greater emphasis on firms' policies and procedures regarding the circulation of rumors?" Although this is an important inquiry, the compliance burdens posed by the Proposed Rule are not a function of what is explicitly required or not required, but are instead inherent in the Proposed Rule itself – its extremely broad proscriptions and the open-ended nature of its reporting obligations. Thus, more guidance from FINRA on policies and procedures would not lessen the compliance burdens posed by the Proposed Rule.

III. The Proposed Rule Could Damage Market Efficiency

The FSA's recent guidance on rumors eloquently describes the value of the free flow of information, including legitimate expressions of opinion, to market efficiency:

> The flow of information, when communicated responsibly, is an essential element of efficient markets. Rumours are legitimately circulated through the financial system for a variety of reasons. It is customary for market participants to discuss

> rumours when accounting for the source of market volatility; when offering an objective assessment of a rumour's likelihood to a client; and when attempting to better understand observable market behaviour.

The FSA recognized that, at times, it is virtually impossible not to discuss rumors in fielding investor questions about the causes of otherwise unexplained market volatility. In such circumstances, the ability to freely discuss rumors with investors or other market professionals for the purpose of debunking them can be enormously helpful to investors and issuers alike, and highly beneficial to the efficiency of the market.

The SEC and the Supreme Court have also expressly recognized that diligent market analysis and its dissemination are legal and should be encouraged. The SEC has acknowledged "[t]he value to the entire market of [analysts'] efforts. . . . [M]arket efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information."[3] The Supreme Court has similarly praised analysts' efforts to gather information:

> [market analysts are] necessary to the preservation of a healthy market. It is commonplace for analysts to . . . meet . . . with and question . . . corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities . . . . It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.[4]

The SEC stated thirty-seven years ago that the focus of its investigations should be to "polic[e] insiders and what they do. . . rather than . . . policing information *per se* and its possession."[5] In *Dirks*, the Supreme Court quoted with approval the fact that "[t]he SEC expressly recognized that '[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors.'"[6]

By not defining the term "rumor" and by not limiting the scope of the Proposed Rule to rumors that are false and material, the Proposed Rule could have a chilling effect on legitimate

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[3] *In re Dirks*, Exchange Act Release No. 17480, 21 SEC Docket 1401, 1406 (January 22, 1981).

[4] *Dirks, supra*. *See also United States v. Carpenter, supra* at 1031:

> There are disparities in knowledge and the availability thereof at many levels of market functioning that the law does not presume to address. . . . Obviously, one may gain a competitive advantage in the marketplace through conduct constituting skill, foresight, industry and the like.

[5] *Dirks v. SEC*, 463 U.S. 646, 662-663 (1983) (quoting *In re Investors Management Co.*, 44 S.E.C. 633, 648 (1971) emphasis in original).

[6] 21 S.E.C. Docket at 1406. *Id*. at n. 32.

analysis and expressions of opinion because it would be difficult to know what is permitted and what is illegal.

IV. The Proposed Rule's Reporting Obligations Are Impractical

The obligation to report to FINRA "any circumstances which reasonably would lead the member to believe that any . . . rumor might have been originated or circulated" is impractical. This reporting obligation is broader[7] and more burdensome than any other reporting obligation in FINRA rules.

There are probably hundreds, if not thousands, of instances every day in which innocent opinions about securities are shared among market professionals. Some are facts, some opinions, some are complete conjectures. In many cases, it is difficult, in practice, to determine whether the comment is fact, opinion, conjecture, or lie. In order to comply with the proposed reporting obligations with respect to rumors, a member firm would need to detect every such comment, gather sufficient information about the rumor to provide a meaningful report to FINRA, and then report the information. Having reported the information to FINRA, the member firm would naturally seek to control the "circulation" of the comment, in order to avoid possible sanction by FINRA for failure to respond to a possible violation of FINRA rules. FINRA, in turn, would be flooded with reports that it would probably feel obligated to investigate. The proposed reporting obligation could operate to transform what has heretofore been a minor area of enforcement attention into an all-preoccupying obsession of both member firms and FINRA. This could lead to the diversion of resources from more important areas.

These burdens are exacerbated by FINRA's decision not to retain the exception in NYSE Rule 435(5) respecting information published by widely circulated media. The elimination of this exception, coupled with the incorporation of language from NASD Rule 6140 that expands the scope of the rule to rumors that either are false or misleading (but not sensational) or improperly influence the price of a security (but may in fact be true), raises the specter of a veritable reporting "feeding frenzy." In the past, if a widely watched cable news network, news outlet or Internet reporting service published or disseminated information that was either false or misleading, or had a pronounced but improper impact on the price of a stock, the fact of its publication would serve to nullify an obligation by a member firm or its employees to report any private e-mails or phone conversations respecting the same information. Under the Proposed Rule, member firms would now have that obligation even if they had not been personally contacted and the only manner in which the information was circulated to them was via the broadcast, news report or Internet service.

Since FINRA has already developed computer systems to monitor market trading activity for possible insider trading and market manipulation, FINRA already has the tools to detect unusual movements in the prices of securities. When such unusual movements occur, FINRA already has the enforcement power to investigate. These mechanisms already permit FINRA to detect, investigate, and, if appropriate, to prosecute improper rumor mongering. A whole new system of reporting laid on top of this existing mechanism appears to serve no useful purpose.

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[7] The NASD rule contains no reporting obligation. The NYSE rule requires reporting when the member has "reason to believe" that a rumor is being circulated for the purpose "of influencing prices in listed securities."

V. The FSA Approach to Rumors

NSCP notes that the FSA approach to rumor mongering has a number of strengths. First, the FSA offers a useful definition of the conduct it intends to prohibit.[8] Second, the FSA focuses on the development of policies and procedures, rather than a list of prohibited practices. Finally, and most important, NSCP commends the FSA's emphasis on industry best practices,[9] rather than mandating a "one size fits all" approach. NSCP also notes that the FSA has prudently declined to require reporting of rumors to regulators.

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In sum, NSCP recommends that the Proposed Rule not be adopted. Instead, to address the perceived abuse of rumor mongering, NSCP endorses an approach akin to that already implemented by the FSA. Under the FSA approach, industry best practices have been proposed to enhance compliance systems at member firms. This approach, in NSCP's view, appropriately balances the need for greater efforts to control rumor mongering against the dangers, set forth above, of an overzealous effort to suppress the sharing of opinions among market professionals.

If FINRA elects to pursue a different approach to responding to rumors, NSCP would be delighted to work with FINRA in formulating this revised approach.

Questions regarding our comments or requests for additional information should be directed to the undersigned at 860.672.0843.

Very truly yours,

Joan Hinchman
Executive Director, President and CEO

[8] "By rumour, we mean information that is circulated purporting to be fact but which has not yet been verified. A statement is unlikely to be considered a rumour if it is clearly an expression of an individual's or firm's opinion, such as an analyst's view of the prospects of a company."

[9] "This article sets out industry best practice in this area. These include the introduction of formal policies on the handling of rumours. Among other requirements, these policies set clear rules as to whom, in what circumstances, and in what form such information can be passed. They also spell out a clear prohibition on utilising rumours for the purposes of market manipulation. Policies on handling rumours are communicated to staff through formalised training programmes and compliance then monitors both proactively and retrospectively by investigating communications surrounding suspicious price movements."