crosses of SPX compression forum orders without exposure and they will be available at any point during a month designated by the Exchange rather than just at the end of each calendar week, month, and quarter, as is the case under the current compression forum process.

The affiliation of clearing brokers with bank holding companies has introduced the need for liquidity providers and their clearing firms to more conservatively manage holdings to comply with applicable bank regulatory capital requirements, which particularly affects SPX options given the large notional exposure associated with holdings of SPX by liquidity providers in SPX across a large number of strikes and series. While these positions may be hedged, the applicable bank capital rules currently disregard offsets when calculating the notional value of short positions. As a result, the ability to close and ''compress'' positions in an efficient, cost-effective manner can help liquidity providers and their clearing firms reduce risk weighted assets and alleviate associated bank capital constraints.

The current floor-based compression forums are labor-intensive and can be inefficient as a result. The Exchange asserts that this proposal will increase the efficiency of SPX compression activity without causing any significant negative effect on price discovery or the ability of a TPH to access liquidity.[24] The commenters on the proposal similarly believe the proposal will increase efficiency by providing an electronic risk management tool to reduce SPX risk weighted assets, which will support the ability of SPX liquidity providers to provide displayed quotes in SPX options.[25] Accordingly, PCC orders can help assure the continued availability of capital to liquidity providers so that they can quote competitively with size, particularly during periods of heightened volatility, which removes impediments and supports fair and orderly markets to the benefit of investors.

The proposed PCC order type contains the same priority protections that apply under Rule 5.24(e)(1)(E) when the Exchange permits electronic compression orders as clean crosses when its trading floor is inoperable.[26] Likewise, PCC orders handled by floor brokers will be covered by the same protections.[27] Additionally, under the proposal, TPHs will be permitted to enter PCC orders in the same increment that is currently available for closing transactions in open outcry compression forums, which are increments of $0.01.[28]

The Exchange states that the benefits of permitting PCC orders to execute as clean crosses greatly outweigh any detriments that may result from not exposing these orders for potential break up.[29] The Exchange notes that the benefits of requiring a TPH to expose an order or a proposed cross generally flow to that order, which benefits include the potential for price improvement and, for single orders, to locate contra-side liquidity.[30] In the case of an SPX transaction to reduce risk weighted capital for which a TPH could use the PCC order type, the representing TPH has already located the necessary liquidity prior to submitting the matches for execution, and the ability to execute the single or complex order in full to reduce risk weighted capital is the primary concern.[31] Any likelihood of another TPH breaking up the PCC order could deter the order-originating TPH from entering its compression order, which would fail to achieve the aims of the compression order and thus fail to mitigate the associated capital constraints that could impact the liquidity provider's continued ability to quote SPX series.[32]

Based on the foregoing and for the above reasons, the Commission finds that the proposed rule change is consistent with the requirements of the Act in that it is designed 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.

IV. Conclusion

It is therefore ordered that, pursuant to Section 19(b)(2) of the Act,[33] the proposed rule change (SR–CBOE–2020–074) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[34]

J. Matthew DeLesDernier,

Assistant Secretary.

[FR Doc. 2020–23150 Filed 10–19–20; 8:45 am]

BILLING CODE 8011–01–P

[24] *See* Notice, *supra* note 3, at 55041.

[25] *See supra* note 4 (citing to the comment letters on the proposal).

[26] *See* Notice, *supra* note 3, at 55045. The Commission also notes that the proposal only allows a TPH to use PCC orders to reduce the required capital associated with the TPH's open SPX positions and the Exchange represents that the Exchange's Regulatory Division will incorporate PCC orders into its surveillance. *See id.* at 55049.

[27] *See id.*

[28] *See id.* at 55043.

[29] *See id.* at 55048.

[30] *See id.*

[31] *See id.* at 55049. *See also supra* note 27.

[32] *See* Notice, *supra* note 3, at 55049.

[33] 15 U.S.C. 78s(b)(2).

[34] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–90176; File No. SR–FINRA–2020–032]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Adjust FINRA Fees To Provide Sustainable Funding for FINRA's Regulatory Mission

October 14, 2020.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on October 2, 2020, the 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 ''establishing or changing a due, fee or other charge'' under Section 19(b)(3)(A)(ii) of the Act[3] and Rule 19b–4(f)(2) thereunder,[4] 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 adjust FINRA fees to provide sustainable funding for FINRA's regulatory mission.

The text of the proposed rule change is available on FINRA's website at *http://www.finra.org,* at the principal office of FINRA and at the Commission's Public Reference Room.

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] 15 U.S.C. 78s(b)(3)(A)(ii).

[4] 17 CFR 240.19b–4(f)(2).

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

Overview

FINRA is submitting this proposed rule change to increase the revenues that FINRA, as a not-for-profit self-regulatory organization (''SRO''), relies upon to fund its regulatory mission. The proposed fee increases are designed to better align FINRA's revenues with its costs while preserving the existing equitable allocation of fees among FINRA members. FINRA has not raised its core member regulatory fees since 2013, even though the overall costs of FINRA's operations have exceeded its total revenues for most of the last decade.

Although the proposed fee increases will not begin to take effect until 2022, FINRA is submitting this proposed rule change now so that it can: (1) Provide significant advance notice of the proposed fee increases to member firms; (2) permit the proposed fee increases to be phased in over multiple years; and (3) continue to strategically ''spend down'' financial reserves over the next several years, to allow the proposed increases to be gradually phased in as much as possible. The proposed fee increases are intended to provide responsible and sustainable longer-term funding to enable FINRA to accomplish its regulatory mission in a manner consistent with FINRA's public Financial Guiding Principles (''Guiding Principles'').[5]

Background

Over the last decade, FINRA's regulatory responsibilities have grown significantly, driven by the proliferation of new investment products and services, the increase in the number of trading venues and trading volumes, the adoption by the SEC of important new rules that FINRA is charged with overseeing, and other regulatory mandates and market developments.

For example, FINRA must supervise an increasingly complex array of broker-dealer services provided by member firms in the context of a constantly evolving securities market structure. New financial products, such as digital assets and increasingly intricate exchange-traded products, and new trading venues, coupled with pronounced growth in trading volume, require increased examination and surveillance by FINRA staff. In addition, FINRA has made substantial investments in technology and staff to supervise or comply with significant new rules adopted by the SEC, such as the Consolidated Audit Trail, Regulation Best Interest, the Market Access Rule, Regulation Systems Compliance and Integrity, Regulation Crowdfunding, rules concerning the oversight of municipal advisors and security-based swap activities, and amendments to Regulation ATS, Regulation SHO, and Rule 606 of Regulation NMS, among others.

During this time, FINRA has also committed significant resources to support the SEC's increasing reliance on, and oversight of, FINRA as a first-line supervisor of broker-dealers.[6] For example, in 2019, the SEC's Office of Compliance Inspections and Examinations conducted more than 160 examinations of FINRA, including examinations of critical FINRA program areas as well as oversight reviews of FINRA examinations.[7]

Despite these increasing responsibilities, FINRA has not increased its core regulatory fees materially since 2010 and has not raised these fees at all since 2013. As described more fully below, FINRA has been able to defer fee increases for so long by (1) strategically spending down its financial reserves, and (2) carefully managing its expenses.

As discussed in the Guiding Principles, FINRA has relied on its financial reserves, which originally derived from the sale of Nasdaq, to help support its regulatory mission. From 2010 through 2019, FINRA used over $600 million of its financial reserves to fund operating losses and defer fee increases. On average, this support from FINRA's financial reserves amounted to 6.6% of FINRA's operating budget per year. Information about FINRA's financial reserves is provided each year in FINRA's published annual financial reports.[8]

Careful expense management is another key element of the Guiding Principles. Over the last decade, FINRA has managed its expenses responsibly, controlling costs through various initiatives to enhance efficiency and effectiveness. One critical component of FINRA's success in meeting its expanding regulatory responsibilities while exercising careful expense management is the FINRA360 initiative, which launched in 2017 as a comprehensive self-evaluation to identify opportunities for improvement in FINRA's effectiveness and efficiency.[9] FINRA has also made significant investments in technology, including cloud computing and data science, to enhance regulatory effectiveness with cost-effective tools.

As a result of these efforts, FINRA's expense growth rate from 2010 through 2019 was less than the rate of inflation and significantly lower than expense growth at member firms.[10] Specifically, FINRA's costs increased by 16% cumulatively during the period compared with 42% for the industry, while U.S. core inflation grew by 19%. FINRA's restrained expense growth is the result of careful management of both compensation costs, the largest driver of FINRA's budget, and non-compensation costs. FINRA has been able to maintain relatively flat staffing levels over the last decade and low cumulative compensation growth when compared with average U.S. employee wage growth over the period. FINRA has further been successful in reducing its non-compensation related expenses in recent years, with significant reductions in the last five years across operating expenses (excluding technology) and non-recurring expenses.[11]

[5] *See* FINRA's Financial Guiding Principles, *available at https://www.finra.org/sites/default/files/finra_financial_guiding_principles_0.pdf.*

[6] *See* Inside the National Exam Program in 2016, Marc Wyatt, Director, Office of Compliance Inspections and Examinations, *available at https://www.sec.gov/news/speech/inside-the-national-exam-program-in-2016.html.*

[7] *See* 2020 Examination Priorities, SEC Office of Compliance Inspections and Examinations, *available at https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2020.pdf,* at 2.

[8] *See infra* note 45 and accompanying discussion of the reports FINRA publishes and maintains on its website.

[9] Detailed information about the FINRA360 initiative is *available at https://www.finra.org/about/finra-360.*

[10] FINRA recognizes that firms' expense growth, like that of FINRA, has been driven in part by their increased compliance responsibilities.

[11] *See infra* notes 48 through 50 and 53 through 54 and associated discussion for more detailed analysis of the figures discussed in this paragraph and supporting sources. In this paragraph and where noted below, FINRA's discussion of its expenses and revenues over the past decade draw

Continued

FINRA will continue to carefully manage costs and strategically spend down reserves in the years ahead, but these steps alone are not a sustainable financial strategy in the long term, particularly in the context of FINRA's increasing regulatory responsibilities and finite reserves. Accordingly, consistent with the Guiding Principles, FINRA proposes at this time to adopt a schedule of future fee increases to address the structural deficit in FINRA's budget and provide sustainable funding to carry out its regulatory mission. This proposal is designed around several core elements: (1) Significant advance notice to members before increases take effect, with continued reasonable reliance on FINRA's financial reserves to allow the proposed fee increases to be deferred and gradually phased-in as much as possible; [12] (2) proportional fee increases that largely preserve the existing allocation of fees among members; and (3) FINRA's ongoing commitment to reasonable cost management and rebates to members where revenues exceed costs. These elements are discussed in detail below.

FINRA's Current Fee Structure

As a not-for-profit self-regulatory organization, FINRA relies on a mix of fees that are intended to cover the overall costs of FINRA's operations. The most significant sources of FINRA's funding are three core regulatory fees: The Gross Income Assessment (''GIA''); the Trading Activity Fee (''TAF''); and the Personnel Assessment (''PA''). These fees are used to substantially fund FINRA's regulatory activities, including examinations, financial monitoring, and FINRA's policymaking, rulemaking, and enforcement activities.[13] Where appropriate, FINRA also employs use-based fees for some of the specific services and data it provides to members and the public in support of its regulatory mission.[14]

As FINRA has explained in connection with prior filings to the Commission, because FINRA is a not-for-profit entity it employs this mix of fees to seek recovery of its overall costs in a manner that is fair, reasonable, and equitably allocated among FINRA's member firms. Broadly speaking, each of FINRA's core regulatory fees reflects one of the critical components driving FINRA's regulatory costs with respect to a particular member firm: The size of the firm (measured by revenue), the firm's trading activity; and the number and role of persons registered with the firm.[15]

However, FINRA has addressed in prior filings how, in light of its diverse membership of firms that vary greatly in size and business model, it is impossible to develop a comprehensive pricing scheme that precisely accounts for the particulars of each member.[16] Because it is not feasible to associate a direct affiliated revenue stream for each of FINRA's programs—for example, examinations of member firms do not have an associated revenue stream—FINRA has explained that numerous operations and services must be funded by general revenue sources, which include both regulatory assessments and use-based fees.[17] Similarly, there is no one consistent driver of costs of a particular regulatory program. Even where one cost driver may, at times, align with a particular revenue stream (*e.g.,* as trading activity increases, certain Market Regulation costs may increase), the relationship is not uniform or linear. For instance, novel trading patterns in single or multiple securities may not be associated with significant volume but may require disproportionately large regulatory investment. Likewise, periods of intense market volatility may influence regulatory costs independent of the change in trading volume. As such, FINRA must ensure sufficient funding to meet all of its regulatory obligations notwithstanding the fluctuations in different revenue streams and cost drivers that are naturally expected to occur.

Consistent with this framework, FINRA uses an overall cost-based pricing structure designed to be reasonable, achieve general equity across its membership, and correlate fees with regulatory costs to the extent feasible. Notably, the Commission has approved FINRA's approach to this overall pricing structure and agreed that it ''is reasonable in that it achieves a generally equitable impact across FINRA's membership and correlates the fees assessed to the regulatory services provided by FINRA.'' [18] FINRA continues to believe that this approved approach to overall pricing is the most feasible and equitable way to provide sufficient funding to meet its regulatory obligations given its role as a not-for-profit national securities association and its broad, diverse membership.

FINRA has long used rebates to support its commitment to reasonable, cost-based fee assessments in instances where revenues significantly exceed expenditures. For example, FINRA distributed rebates to members each year from 2000 to 2014. In these years, FINRA generally first distributed to all active members in good standing an initial amount intended to offset their minimum GIA fee,[19] and additional rebates were then provided based on these members' prorated share of

---

from the figures that FINRA publishes each year in its Annual Financial Report. Because FINRA's Annual Financial Reports present audited financials on a consolidated basis, these figures include the expenses and revenues for FINRA subsidiaries. Over the last decade, there have been three primary subsidiaries in addition to FINRA Regulation, FINRA's regulatory subsidiary: FINRA Dispute Resolution, the FINRA Investor Education Foundation, and FINRA CAT, LLC. FINRA Dispute Resolution was merged into FINRA Regulation at the end of 2015; the FINRA Investor Education Foundation has existed throughout the last decade, and FINRA CAT, LLC was formed in 2019. While the costs and revenues for these subsidiaries are included where historic expense and revenue figures are drawn from FINRA's consolidated Annual Financial Reports, the FINRA Investor Education Foundation and FINRA CAT, LLC subsidiaries are budgeted for separately and not included in FINRA's public budget summaries; accordingly, where budget projections are discussed in this filing, they do not include the expenses or revenues of FINRA subsidiaries other than FINRA Regulation.

[12] As discussed further below, consistent with the Guiding Principles, FINRA strives to maintain an appropriate level of reserves, which the FINRA Board of Governors has determined to be at least one year of expenditures.

[13] *See, e.g.,* Securities Exchange Act Release No. 61042 (November 20, 2009), 74 FR 62616 (November 30, 2009) (Order Approving File No. SR–FINRA–2009–057).

[14] The services covered by these fees currently include initial and annual member registrations, qualification examinations, reviews of corporate filings, review of advertisements and disclosures, and transparency and dispute resolution services. While each of these services has unique attributes, fees for these services generally are based on the use of a particular service. When applying use-based fees, FINRA takes into account three associated types of costs: Direct costs for the program associated with the use-based fee, such as program building and operating expenses, and reinvestments and enhancements; indirect costs for the program, including supporting services necessary for the program's associated regulatory activity; and a contribution to FINRA's overall regulatory operations. *See, e.g.,* Securities Exchange Act Release No. 67247 (June 25, 2012), 77 FR 38866 (June 29, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR–FINRA–2012–030) (discussing how registration fees contribute to FINRA's overall regulatory funding).

[15] The number and role of registered persons also correlates with FINRA's registration, and qualification examination fees, so increases in these fees are also used to equitably allocate the fees across these components of FINRA's costs.

[16] *See* Letter to Elizabeth M. Murphy, Secretary, SEC, from Brant Brown, Associate General Counsel, FINRA, dated June 19, 2012 (FINRA Response to Comments on File No. SR–FINRA–2012–023).

[17] *See* Letter to Elizabeth M. Murphy, Secretary, SEC, from Philip Shaikun, Associate Vice President and Associate General Counsel, FINRA, dated August 3, 2012 (FINRA Response to Comments on File Nos. SR–FINRA–2012–028; SR–FINRA–2012–029; SR–FINRA–2012–030; and SR–FINRA–2012–031).

[18] *See* Order Approving SR–FINRA–2009–057, *supra* note 13, 74 FR at 62620.

[19] As discussed below, the minimum GIA fee is $1,200 per year and would remain unchanged by this proposal.

regulatory fees paid into FINRA.[20] To maintain equivalence between revenues and costs, FINRA will be guided by its historical approach to rebates if its revenue in future years exceeds its costs by a material amount.[21] FINRA's commitment to reasonable cost-based fee levels is further reinforced by its financial transparency, including the revenue and cost information FINRA makes public each year.

Proposal

FINRA is proposing a proportional increase to fees it relies on to substantially fund its regulatory mission in a manner that preserves equitable fee allocation among FINRA members. Specifically, FINRA is proposing increases to its GIA, TAF, PA, member registration, and qualification examination fees, phased in over a three-year period beginning in 2022, as described in detail below for each specific fee change.

In sum, FINRA is targeting the proposed fee increases to generate an additional $225 million annually once fully implemented in 2024. This targeted revenue amount is calculated to bring FINRA's revenues in line with its anticipated costs, based on FINRA's projected revenue and costs.[22] As FINRA noted recently in its 2020 Annual Budget Summary, based on the current fee structure FINRA projected that its overall costs will exceed revenues by $210.2 million in 2020.[23] FINRA projects it will need $225 million in additional annual revenue from the fee increases proposed in this filing by 2024 to achieve sustainable funding for its current regulatory mission, in line with its Guiding Principles.[24]

Overall, the total fee increase represents just under a 5% compounded annual growth rate (''CAGR'') across all FINRA fees between this year and when the proposal is fully implemented in 2024.[25] When measured more specifically against the groups of fees impacted by this proposal (FINRA's regulatory fees, along with qualification examination and registration fees), the proposal represents a 6.5% CAGR over the same time frame. However, as explained above, because FINRA has been able to defer raising fees for a number of years because of careful expense management and reliance on its financial reserves, FINRA also believes it is appropriate to measure the rate of fee increases since 2011, the year following the last material regulatory fee increase. When measured over this period (2011 through 2024), the proposal represents a 2.4% CAGR across all FINRA fees and a 3.1% CAGR across the groups of fees impacted by this proposal. While this increase is material, FINRA's fees will continue to represent a very small dollar amount relative to industry revenues as reported in FOCUS reports—specifically, when the proposal is implemented in 2024, FINRA estimates that the FINRA fees impacted by the proposal would represent approximately 0.22% (22 basis points) of recent industry revenues.[26]

In essence, the proposal is designed to preserve the same SEC-approved, equitable fee allocation across members that FINRA has maintained for years. By pursuing a proportional aggregate increase, FINRA designed the proposal to change the distribution of fees across members as little as possible. In other words, FINRA designed the proposal to achieve the targeted revenue amount needed to correct FINRA's structural deficit—expected to be $225 million by 2024—with a package of specific fee increases that best yielded an equitable overall fee increase across member firm size and type. The five fees included in this proposal—the GIA, TAF, PA, registration, and qualification examination fees—were selected to achieve an overall proportional increase, with minimal distributional impact, because they are the most broadly assessed fees that FINRA relies on to fund its regulatory mission, and they match the main member firm components of FINRA's regulatory costs. By using a combination of fees that apply to different components of a firm's activities, the increase in fees maintains the equitable distribution of fees across varying types of member firms.

When these five fees are grouped according to the three main components of FINRA's regulatory costs—the size of the member firm (GIA), the firm's trading activity (TAF), and the number and role of registered persons with the firm (PA, registration, and qualification examination fees)—they have each

[20] *See, e.g.,* FINRA 2014 Annual Financial Report, *available at https://www.finra.org/sites/default/files/2014_YIR_AFR.pdf,* at 9.

[21] These rebates are approved by the FINRA Board of Governors. A number of factors must be considered when determining whether to provide rebates, including the amount of excess revenue for the year, whether budget projections anticipate near-term revenue shortfalls, and the number of firms that would be eligible to receive rebates. As discussed throughout the filing, FINRA makes information about these factors transparent to the public each year.

[22] Anticipated costs would not include potential costs associated with new services that may be initiated or approved in the future. FINRA may submit separate fee filings to cover program costs for new services. Similarly, FINRA notes that program costs associated with the reporting of transactions in U.S. Treasury Securities (''Treasuries'') are not included in the targeted amount sought by this proposal; currently, Treasuries transactions are exempted from both TRACE transaction reporting fees and from the TAF. *See* Securities Exchange Act Release No. 79116 (October 18, 2016), 81 FR 73167, 73176 (October 24, 2016) (Order Approving File No. SR–FINRA–2016–027).

[23] *See* FINRA 2020 Annual Budget Summary, *available at https://www.finra.org/sites/default/files/2020-05/2020_annual_budget_summary.pdf,* at 2. Budget projections discussed in this filing are based on the figures used for the 2020 Annual Budget Summary. Budget projections are evaluated throughout the year, and the steps FINRA would take in the event of materially changed projections are discussed *infra* note 27 and its associated text. FINRA has provided a detailed program-level summary of its recent budgeting trends from 2018 through 2020 in Chart 1 of Exhibit 3 to this filing. As noted in the chart, while certain program-level budget figures incorporate the costs of contract services, these costs are funded in full by contract fees. Therefore, FINRA's contract services are not funded with any of the regulatory revenues discussed in this filing, and contract service costs do not cause any of the projected revenue shortfalls that this filing is designed to correct. For example, to the extent the direct costs of services provided under Regulatory Services Agreements (''RSAs'') are included in the budget shown for Market Regulation, those direct costs are accounted for and fully offset by the revenues derived from the agreements. This includes the costs of shared resources used to provide services under the RSAs, as such costs are tracked and allocated under the agreements. In the event there is an expansion, modification, or termination of such agreements, FINRA would make corresponding adjustments to its budget projections.

[24] For purposes of its projections, FINRA assumed a conservative amount of fine money for future years based on historic fine money receipt. FINRA's projections further assumed investment gains of 4.5% annualized, consistent with historical results and FINRA's investment policy.

Like other SROs, FINRA routinely imposes fines on its members or their registered representatives for violations of applicable SEC or SRO rules. Although SROs are not generally restricted by applicable law or regulation in terms of how they may use fine monies, FINRA has determined pursuant to its Guiding Principles to adopt several policies designed to ensure that the collection and use of fine monies are consistent with FINRA's public-interest mission. In particular, the imposition and amount of fines are not based on revenue considerations; FINRA does not establish any minimum amount of fines to be collected for purposes of the FINRA annual budget; fines are not considered in determining employee compensation; FINRA accounts for fine monies separately; fine monies may only be used upon approval by the Board of Governors for certain designated purposes, including for example capital initiatives or non-recurring strategic expenditures that promote effective and efficient regulatory oversight by FINRA; and FINRA publishes an annual report detailing how fine monies have been used. (For example, see FINRA's Report on Use of 2019 Fine Monies, *available at https://www.finra.org/about/annual-reports/report-use-2019-fine-monies.*)

[25] Compound average growth rate provides a geometric average of the change in fees over the implementation period. It is particularly useful for comparing growth rates from various sets of data over the same multi-year period.

[26] As discussed below, this estimate measures the amount of FINRA's regulatory and use-based fees expected in 2024 as a percentage of 2019 industry revenues, assuming no FOCUS revenue growth for member firms over that time period.

contributed roughly the same total revenue by group for the last five years, and collectively they account for roughly 60% of FINRA's total revenues. The proposal is therefore designed as a proportional fee increase, splitting the proposed aggregate fee increase amount of $225 million evenly across these three categories—$75 million from the GIA, $75 million from the TAF, and $75 million collectively from the representative-based fees (PA, registration, and qualification examination fees). FINRA believes this proportional approach to fee increases will provide member firms a greater degree of certainty and predictability, as it seeks to maintain consistency with FINRA's existing equitable fee distribution. FINRA further believes its proportional approach reduces the potential for unintended impacts on the services provided by member firms, and the business models they adopt, that could arise from significant changes to fee distribution.

To further promote predictability for member firms, FINRA designed the proposal to reach the total targeted revenue amount in 2024 as part of a gradual, multi-year phase-in beginning in 2022. As noted above, during this time, FINRA will continue to draw an estimated $400 million from its financial reserves to support the phased implementation. FINRA currently projects it can continue to fund its annual budget deficits from its reserves during the implementation period, at the end of which FINRA projects that its remaining reserves will align with the Board-approved level of appropriate reserves, noted in the Guiding Principles, equal to one year of operating costs. Discussions with members to date confirm that providing notice to member firms now of a future fee increase—with a phase-in beginning in 2022—will provide members with greater certainty regarding their future fee expenses that will be very valuable in their annual budgeting and financial planning processes. If FINRA's actual structural financial deficit is materially reduced during this period relative to current projections—for example, because key assumptions used in those projections are overly conservative—FINRA would submit a new filing to further defer the proposed fee increases or consider other modifications as appropriate.[27]

Gross Income Assessment

The GIA is a core regulatory fee designed to correlate to one of the three critical components of FINRA's regulatory costs, the size of a firm. Accordingly, the GIA is based on a firm's annual gross revenue,[28] employing a seven-tier rate structure that has applied since 2008.[29] The current rates are as follows:

(1) $1,200 on annual gross revenue up to $1 million;

(2) 0.1215% of annual gross revenue greater than $1 million up to $25 million;

(3) 0.2599% of annual gross revenue greater than $25 million up to $50 million;

(4) 0.0518% of annual gross revenue greater than $50 million up to $100 million;

(5) 0.0365% of annual gross revenue greater than $100 million up to $5 billion;

(6) 0.0397% of annual gross revenue greater than $5 billion up to $25 billion; and

(7) 0.0855% of annual gross revenue greater than $25 billion.

FINRA is proposing the following changes to its GIA tier rates between 2022 and 2024: [30]

GIA—PROPOSED IMPLEMENTATION

Tier (revenue)	2020 (current)	2021 (no change)	2022	2023	2024
$0 to $1 million	$1,200	$1,200	$1,200	$1,200	$1,200
Greater than $1 million up to $25 million	0.1215%	0.1215%	0.1346%	0.1511%	0.1732%
Greater than $25 million up to $50 million	0.2599%	0.2599%	0.2880%	0.3232%	0.3705%
Greater than $50 million up to $100 million	0.0518%	0.0518%	0.0574%	0.0644%	0.0738%
Greater than $100 million up to $5 billion	0.0365%	0.0365%	0.0404%	0.0454%	0.0520%
Greater than $5 billion up to $25 billion	0.0397%	0.0397%	0.0440%	0.0494%	0.0566%
Greater than $25 billion	0.0855%	0.0855%	0.0948%	0.1063%	0.1219%

As stated previously, when the new GIA rates are fully implemented in 2024, they are designed to generate an additional $75 million annually. The proposed GIA increase preserves the existing seven-tier structure and calculation method. With these proposed increases, the GIA structure would continue to reflect the costs associated with performing regulatory responsibilities across FINRA's diverse population of member firms. The proposal would not increase the flat $1,200 fee for member firms with revenues of $1 million or less. Maintaining this fee level for the smallest member firms preserves FINRA's existing approach to cost distribution between member firms of varying sizes, which, as discussed in further detail below, seeks to prevent regulatory costs from creating an inappropriate barrier to entry. For rates applicable in tiers two through seven, the proposed changes represent progressive yearly increases through the implementation period, beginning with a 10.8% increase across tiers in 2022, a 12.2% increase in 2023, and a 14.7% increase in 2024.

[27] Details of the assumptions FINRA used to project costs between 2020 and 2024 are discussed *supra* note 24 and *infra* note 60.

[28] Schedule A to the FINRA By-Laws defines gross revenue for assessment purposes as total income as reported on FOCUS form Part II or IIA, excluding commodities income.

[29] While the GIA rate structure has not changed since 2008, FINRA made modifications to the method of GIA calculation under the structure in 2009 and 2014. In 2009, the Commission approved a GIA calculation modification designed to mitigate year-to-year revenue volatility by assessing member firms the greater of a GIA calculated based on the firm's annual gross revenue from the preceding calendar year, or a GIA averaged over the prior three years. *See* Order Approving SR–FINRA–2009–057, *supra* note 13, 74 FR at 62617. In 2014, FINRA refined the GIA calculation method to provide limited relief for smaller member firms from unintended effects of the 2009 calculation change; as a result of the 2014 change, firms that have annual gross revenue of $25 million or less pay the GIA based on preceding year revenue without looking to a three-year average. *See* Securities Exchange Act Release No. 73632 (November 18, 2014), 79 FR 69937 (November 24, 2014) (Notice of Filing and Immediate Effectiveness of File No. SR–FINRA–2014–046).

[30] FINRA notes the Exhibit 5 to this proposed rule change is marked to show the changes as they are proposed to take effect each year, as described in this filing. Specifically, Exhibit 5A shows the proposed changes that would take effect in 2022, Exhibit 5B shows the proposed changes that would take effect in 2023, and Exhibit 5C shows the proposed changes that would take effect in 2024.

Trading Activity Fee

The TAF is a core regulatory fee designed to correlate to the second critical component of FINRA's regulatory costs, the trading activity of a firm. FINRA initially adopted the TAF in 2002, modeled on the Commission's transaction-based Section 31 fee.[31] The TAF is generally assessed on the sale of all exchange-listed securities wherever executed (except debt securities that are not TRACE-Eligible Securities), over-the-counter equity securities, security futures, TRACE-Eligible Securities (provided that the transaction is a Reportable TRACE Transaction), and all municipal securities subject to Municipal Securities Rulemaking Board reporting requirements.[32] The current TAF rates, which have not increased since 2012, are:

(1) $0.000119 per share for each sale of a covered equity security, with a maximum charge of $5.95 per trade;

(2) $0.002 per contract for each sale of an option;

(3) $0.00008 per contract for each round turn transaction of a security future, provided there is a minimum charge of $0.01 per round turn transaction;

(4) $0.00075 per bond for each sale of a covered TRACE-Eligible Security (other than an Asset-Backed Security) and/or municipal security, with a maximum charge of $0.75 per trade; and

(5) $0.00000075 times the value, as reported to TRACE, of a sale of an Asset-Backed Security, with a maximum charge of $0.75 per trade.

FINRA is proposing the following changes to its TAF rates between 2022 and 2024:

TAF—PROPOSED IMPLEMENTATION

Security type	2020 (current)	2021 (no change)	2022	2023	2024
Covered Equity Security.	$0.000119 per share (up to $5.95 max per trade).	$0.000119 per share (up to $5.95 max per trade).	$0.000130 per share (up to $6.49 max per trade).	$0.000145 per share (up to $7.27 max per trade).	$0.000166 per share (up to $8.30 max per trade).
Options	$0.002 per contract	$0.002 per contract	$0.00218 per contract	$0.00244 per contract	$0.00279 per contract.
Security Future	$0.00008 per contract (with $0.01 minimum per round trip transaction).	$0.00008 per contract (with $0.01 minimum per round trip transaction).	$0.00009 per contract (with $0.011 minimum per round trip transaction).	$0.00010 per contract (with $0.012 minimum per round trip transaction).	$0.00011 per contract (with $0.014 minimum per round trip transaction).
TRACE-Eligible Security (Other than Asset-Backed Security) or municipal security.	$0.00075 per bond (up to $0.75 max per trade).	$0.00075 per bond (up to $0.75 max per trade).	$0.00082 per bond (up to $0.82 max per trade).	$0.00092 per bond (up to $0.92 max per trade).	$0.00105 per bond (up to $1.05 max per trade).
TRACE-Eligible Asset-Backed Security.	$0.00000075 times reported value (up to $0.75 max per trade).	$0.00000075 times reported value (up to $0.75 max per trade).	$0.00000082 times reported value (up to $0.82 max per trade).	$0.00000092 times reported value (up to $0.92 max per trade).	$0.00000105 times reported value (up to $1.05 max per trade).

When the new TAF rates are fully implemented in 2024, they are designed to generate an additional $75 million annually. The proposed TAF changes reflect proportional increases in the amount raised for each security type—meaning there is no anticipated change in the percentage of overall TAF revenue collected from transactions in each security type—phased in incrementally over the three-year implementation period. Accordingly, while TAF revenues are largely derived from transactions in equity securities, like the SEC's Section 31 fee, this proposal is intended to preserve the existing distribution of TAF fees among security types.

Personnel Assessment

The PA is a core regulatory fee designed to correlate to the third critical component of FINRA's regulatory costs, the number and role of registered persons at a firm. The PA currently is assessed on a three-tiered rate structure: Members with one to five registered representatives and principals are assessed $150 for each such registered person (''Reps'' in the chart below); there is a $140 charge for each of the next 20 registered persons (between 6 and 25); and a $130 charge for each additional registered person beyond 25. These rates have not increased since 2010.[33] FINRA is proposing the following increases to its PA tier rates between 2022 and 2024:

PA—PROPOSED IMPLEMENTATION

Tier (Number of Reps)	2020 (current)	2021 (no change)	2022	2023	2024
Reps 0–5	$150	$150	$160	$180	$210
Reps 6–25	140	140	150	170	200
Reps 26 and greater	130	130	140	160	190

[31] *See* Securities Exchange Act Release No. 46416 (August 23, 2002), 67 FR 55901 (August 30, 2002) (Notice of Filing and Immediate Effectiveness of File No. SR–NASD–2002–98).

[32] Certain types of transactions are excluded from the TAF—for example, primary market transactions, proprietary transactions executed by a member on a national securities exchange in the member's capacity as an exchange specialist or market maker, and transactions in U.S. Treasury Securities. *See* FINRA By-Laws, Schedule A, Section 1(b)(2) (providing full list of transactions exempt from the TAF). This proposal would not change the scope of any current TAF exemptions, and as discussed *supra* note 22, the proposed TAF rates shown in the chart below for TRACE-Eligible Securities do not apply to Treasuries transactions.

[33] *See Regulatory Notice* 09–68 (November 2009).

When the new PA rates are fully implemented in 2024, they are designed to generate an additional $38 million annually.

Registration Fees

Registration fees are representative-level fees that, while use-based, also correlate to the third critical component of FINRA's regulatory costs, the number and role of registered persons at a firm. Section 4 of Schedule A to the FINRA By-Laws establishes fees connected to FINRA's operation of the Central Registration Depository (''Web CRD®'' or ''CRD system''), the central licensing and registration system for the U.S. securities industry. The CRD system contains the registration records of broker-dealer firms and their associated individuals including their qualification, employment, and disclosure histories; it also facilitates the processing of, among other things, form filings and fingerprint submissions.[34] The CRD system enables individuals and firms seeking registration with multiple states and SROs to do so by submitting a single form, fingerprint card, and a combined payment of fees to FINRA.

While FINRA continually makes investments to improve the CRD system, it has not increased associated registration fees since 2012. FINRA has explained that these fees are important to fund activities that help ensure the integrity of information in the CRD system—information critical to FINRA and other regulators, as well as to investors through BrokerCheck—and to support FINRA's overall regulatory mission.[35] FINRA is proposing to increase certain registration fees between 2022 and 2024 as follows:

REGISTRATION FEES—PROPOSED IMPLEMENTATION

Fee	2020 (current)	2021 (no change)	2022	2023	2024
Initial/Transfer Registration Form U4 filing[36].	$100	$100	$125	$125	$125.
Termination U5 filing	$40 (plus $80 if late filed).	$40 (plus $80 if late filed).	$40 (plus $80 if late filed).	$50 (plus $100 if late filed).	$50 (plus $100 if late filed).
System Processing Fee (for each of the member's registered representatives and principals).	$45	$45	$45	$45	$70.
Branch Office Processing Fee (initial and annual).	$20	$20	$75	$75	$75.
Disclosure review[37]	$110	$110	$110	$155	$155.
Fingerprinting[38]	$15	$15	$15	$20	$20.

FINRA distributed these fee adjustments for registration-related events in a diverse and staggered manner over the implementation period to moderate impact. When all of these proposed registration fee changes are fully implemented in 2024, they are designed to generate an additional $24 million annually.

Qualification Examination Fees

Like registration fees, qualification examination fees are representative-level fees that, while use-based, also correlate to the third critical component of FINRA's regulatory costs, the number and role of registered persons at a firm. Section 4(c) of Schedule A to the FINRA By-Laws sets forth the fees associated with the qualification examinations that FINRA administers. Persons engaged in the investment banking or securities business of a FINRA member who function as principals or representatives are required to register with FINRA in each category of registration appropriate to their functions. Such individuals must pass an appropriate qualification examination or obtain a waiver before their registration can become effective. These mandatory qualification examinations cover a broad range of subjects regarding financial markets and products, individual responsibilities, securities industry rules, and regulatory structure.

FINRA develops, maintains, and delivers all qualification examinations for individuals who are registered or seeking registration with FINRA.[39] FINRA is proposing to increase its examination fees between 2022 and 2024 as follows:

[34] Certain information reported to the CRD system is displayed in BrokerCheck®, an electronic system that provides the public with information on the professional background, business practices, and conduct of FINRA members and their associated persons. Investors use BrokerCheck to help make informed choices about the individuals and firms with which they currently conduct or are considering conducting business.

[35] *See* Securities Exchange Act Release No. 67247 (June 25, 2012), 77 FR 38866 (June 29, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR–FINRA–2012–030).

[36] This fee applies for each initial or transfer Uniform Application for Securities Industry Registration or Transfer (''Form U4'') filed by a member in the CRD system to register an individual. Section 4(b)(1) of Schedule A includes a discount in cases where a member is transferring the registrations of individuals in connection with the acquisition of all or part of another member's business. The discount ranges from 10% to 50%, based on the number of registered personnel being transferred. While FINRA is proposing to increase the registration fee, it is not proposing to make any changes to the discount schedule.

[37] This fee applies for the additional processing of each initial or amended Form U4, Form U5, or Form BD that includes the initial reporting, amendment, or certification of one or more disclosure events or proceedings.

[38] This fee applies for processing and posting to the CRD system each set of fingerprints submitted electronically by a member to FINRA, plus any other charge that may be imposed by the United States Department of Justice for processing each set of fingerprints.

[39] FINRA also administers and delivers examinations sponsored (*i.e.,* developed) by the Municipal Securities Rulemaking Board (''MSRB'') and other SROs, the North American Securities Administrators Association, the National Futures Association, and the Federal Deposit Insurance Corporation. The fees charged for these examinations are set according to contracts with the examination sponsors, and FINRA is not proposing any changes to fees associated with those examinations as part of this proposal. FINRA believes this approach to raising fees only for examinations developed by FINRA is reasonable because this proposal is designed to raise revenues to align with FINRA's core regulatory costs, and the examinations developed by FINRA cover activity most closely associated with FINRA's core regulatory efforts. In addition, the relative number of FINRA-developed examinations, and the relative frequency of their administration, supports the broad distribution of the proposed fee increases in the equitable manner discussed throughout this filing. FINRA notes that because qualification examinations are tied fundamentally to the business an individual engages in, FINRA does not anticipate that the relatively modest proposed fee increases for FINRA's qualification examinations would create material direct competitive impacts. Where FINRA has identified potential competitive impacts of the proposal overall on firms' decision to maintain FINRA registration, it has included discussion *infra* note 66 and associated text. FINRA believes a similar analysis applies for both firms and individuals.

QUALIFICATION EXAMINATION FEES—PROPOSED IMPLEMENTATION

Examination No. and name	2020 (current)	2021 (no change)	2022	2023	2024
Securities Industry Essentials (SIE) Examination	$60	$60	$80	$80	$80
Series 4: Registered Options Principal Examination	105	105	155	155	155
Series 6: Investment Company Products and Variable Contracts Representative Examination	40	40	75	75	75
Series 7: General Securities Representative Examination	245	245	300	300	300
Series 9: General Securities Sales Supervisor Examination—Options Module	80	80	130	130	130
Series 10: General Securities Sales Supervisor Examination—General Module	125	125	175	175	175
Series 16: Supervisory Analyst Examination	240	240	245	245	245
Series 22: Direct Participation Programs Representative Examination	40	40	60	60	60
Series 23: General Securities Principal Examination—Sales Supervisor Module	100	100	105	105	105
Series 24: General Securities Principal Examination	120	120	175	175	175
Series 26: Investment Company Products and Variable Contracts Principal Examination	100	100	150	150	150
Series 27: Financial and Operations Principal Examination	120	120	175	175	175
Series 28: Introducing Broker-Dealer Financial and Operations Principal Examination	100	100	150	150	150
Series 39: Direct Participation Programs Principal Examination	95	95	100	100	100
Series 57: Securities Trader Examination	60	60	80	80	80
Series 79: Investment Banking Representative Examination	245	245	300	300	300
Series 82: Private Securities Offering Representative Examination	40	40	60	60	60
Series 86: Research Analyst Examination—Analysis	185	185	225	225	225
Series 87: Research Analyst Examination—Regulatory	130	130	150	150	150
Series 99: Operations Professional Examination	40	40	60	60	60

When the new examination fee rates are fully implemented, they are designed to generate an additional $13 million annually. FINRA is proposing a single fee raise across examinations in 2022; due to the administrative burden placed on member firms to maintain and distribute comprehensive examination fee schedules continuously throughout the year to the large pool of examination enrollees, FINRA believes that this approach will avoid unnecessary confusion and operational burdens. However, the proposed single-year examination fee increase interacts with the overall package of proposed fee increases in a manner that supports the goal of a gradual three-year phased implementation period. In addition, FINRA has determined the amount of each examination fee increase based on the frequency with which the examination is administered, as well as the average fee per hour of examination length. Examinations that are administered more frequently or are longer in duration typically require more effort and cost to develop, maintain, and update, and FINRA is generally proposing greater increases for these examinations as a result, while the proposed examination fee schedule overall is designed to support the broad and equitable distribution of proposed fee increases, as discussed throughout this filing.

While FINRA has filed the proposed rule change for immediate effectiveness, implementation of the proposed rule change will not begin until January 1, 2022. Beginning in 2022, the fee increases that are the subject of this proposed rule change will be phased in gradually over a three-year period, with full implementation in 2024, to allow FINRA members as much advance notice as possible to plan for these fee increases.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(5) of the Act,[40] which requires, among other things, that FINRA rules provide for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system that FINRA operates or controls. FINRA further believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that FINRA rules are not designed to permit unfair discrimination between customers, issuers, brokers or dealers.[41]

Reasonableness of the Proposed Fees

As discussed above, FINRA's longstanding approach to funding employs a mix of fees designed to meet FINRA's overall costs. As a not-for-profit SRO with a diverse membership, FINRA designs its mix of fees to seek recovery of its overall regulatory costs in a manner that is fair, reasonable, and equitably allocated among FINRA's member firms and users of FINRA's services. As FINRA has explained in the past, it is not feasible to associate a direct affiliated revenue stream for each of its programs (for example, FINRA collects no revenues in connection with its examinations of member firms), and thus numerous operations and services must be funded by other revenue sources, which include both general regulatory assessments and use-based fees. FINRA continues to believe that its overall Commission-approved cost-based pricing structure is reasonable, achieves general equity across its membership, and correlates fees with those firm components that drive FINRA's regulatory costs to the extent feasible.

[40] 15 U.S.C. 78*o*–3(b)(5).

[41] 15 U.S.C. 78*o*–3(b)(6).

The reasonableness of this proposal, designed to generate an additional $225 million annually once fully implemented in 2024, is reinforced by three key cost discipline mechanisms: Oversight, transparency, and rebates.

First, FINRA's funding and operations are subject to several layers of oversight, including by the FINRA Board of Governors [42] and the Commission. As discussed in FINRA's 2020 annual budget summary, FINRA's efforts to manage its expenses responsibly while appropriately funding its mission includes Board oversight of its annual budget, compensation and capital initiatives. This oversight is spearheaded by the Board's key committees (such as its Finance, Operations and Technology Committee), and includes requirements for Board or relevant Committee approval with respect to various financial matters, such as the annual budget, the allocation and use of fine monies, the incurring of any expenses above certain pre-established thresholds, the amount of any annual merit or incentive compensation pools, and the compensation of certain key employees. The Board also relies on expert external consultants where appropriate (*e.g.,* the independent compensation consultant engaged by the Management Compensation Committee). Notably, this Board oversight complements various staff-level controls over routine costs, including expense policies that are enforced with systemic checks and escalating management approval requirements for expense requests, with the effectiveness of these policies further subject to review by FINRA's Internal Audit Department. These controls and the Board's supervision of FINRA's costs has resulted in tightly-controlled expenses that have risen at a rate below that of inflation since 2010.

FINRA is also extensively supervised by the Commission throughout the year. The SEC's Office of Compliance Inspections and Examinations (''OCIE'') maintains dedicated staff as part of its FINRA and Securities Industry Oversight (''FSIO'') program who are devoted exclusively to overseeing FINRA and the MSRB—the two not-for-profit regulatory SROs—including with respect to FINRA's overall financial management and the adequacy of the resources devoted to its regulatory programs. FSIO and other groups within OCIE conducted over 160 examinations of FINRA in 2019 alone.[43] In addition, rules or fees adopted by FINRA are subject to review by the Commission's Division of Trading and Markets. The Commission's oversight of FINRA, in turn, is itself subject to Congressional oversight and evaluation by the United States Government Accountability Office (''GAO'') every three years. By statute, the GAO evaluates ten specific aspects of the Commission's oversight of FINRA, including FINRA governance, executive compensation, and the use of funding to support FINRA's mission, including the methods and sufficiency of funding, how FINRA invests funds pending use, and the impact of these aspects on FINRA's regulatory enforcement. The GAO reports the results of its evaluation to Congress.[44]

Second, FINRA's commitment to reasonable funding in support of its mission is further reinforced by the transparency it has committed to provide on an ongoing basis—pursuant to its Guiding Principles—regarding its financial performance. Each year, FINRA publishes an extensive Annual Financial Report regarding its operations, prepared in accordance with GAAP. In addition, FINRA publishes annual reports on its budget and its use of fine monies. FINRA's Board also reviews and affirms its Financial Guiding Principles each year and re-publishes these as well. FINRA also files with the IRS the Form 990 mandated for all not-for-profit organizations. Collectively, these reports provide extensive and comprehensive information regarding FINRA's policies and operations with respect to its budgets, revenues, costs, financial reserves, use of fine monies, capital and strategic initiatives, and compensation of senior executives, among other information. FINRA maintains a dedicated web page that consolidates its annual reports in a readily accessible place.[45]

Third, FINRA's commitment as a not-for-profit organization to aligning its revenues with its costs, including by providing rebates when revenues exceed costs, ensures that the revenues from these proposed fee changes will remain in line with FINRA's reasonable regulatory costs. As discussed above and below, FINRA distributed rebates to members each year from 2000 to 2014, and FINRA will continue to be guided by its historical approach to rebates if its revenue in future years exceeds its costs by a material amount.

Together, these mechanisms help ensure the ongoing reasonableness of FINRA's costs and the level of fees assessed to support those costs. The effectiveness of these mechanisms is demonstrated by FINRA's experience over the last decade, during which, as discussed above and below, FINRA was able to undertake expanding regulatory responsibilities while limiting cumulative cost growth to a rate that was lower than inflation and cost growth at member firms.

The Proposed Fees Are Equitable and Not Unfairly Discriminatory

As discussed throughout this filing, this proposal is designed to increase the fees FINRA relies on to fund its regulatory mission in a manner that preserves equitable and not unfairly discriminatory fee allocation among FINRA members and users of FINRA services. Notably, through this proposal FINRA is preserving the carefully calibrated mix of general assessment and use-based fees to fund its regulatory mission that the Commission previously approved as equitably allocated among its large and diverse membership.

The five fees included in this proposal—the GIA, TAF, PA, member registration, and qualification examination fees—were selected to meet the necessary funding deficit by raising fees proportionately across member firms with minimal distributional impact, because these five fees are the most broadly assessed fees that FINRA relies on to fund its regulatory mission. When these five fees are grouped according to the three key drivers of FINRA's regulatory costs—the size of the firm (GIA), the firm's trading activity (TAF), and the number and role of registered persons with the firm (PA, registration, and qualification examination fees)—they have contributed roughly the same total revenue by group for the last five years.

The proposal is therefore designed as a proportional fee increase, splitting the proposed aggregate fee increase amount of $225 million evenly across these three cost drivers—$75 million from the GIA, $75 million from the TAF, and $75 million collectively from the representative-based PA, registration, and qualification examination fees. The Commission previously has found aligning fees with these key drivers to be a reasonable basis for the equitable allocation of FINRA's fee assessments.[46]

[42] The FINRA Board of Governors is composed of a mix of public and industry representatives and uses its diverse expertise to oversee management in the administration of FINRA's affairs and the promotion of FINRA's welfare, objectives, and its public service mission to protect investors and uphold the integrity of markets.

[43] *See supra* note 7.

[44] *See* GAO Report to Congressional Committees (July 2018), *available at https://www.gao.gov/assets/700/693217.pdf.*

[45] *See* FINRA Financial Reports and Policies, *available at https://www.finra.org/about/annual-reports.*

[46] *See* Securities Exchange Act Release No. 47106 (December 30, 2002), 68 FR 819, 821 (January 7,

As a result of the proposed proportional increase across the three key drivers of FINRA's regulatory costs, FINRA projects a dispersion level for the rate of increase realized by member firms to be 1.7% once the proposal is fully implemented. In other words, FINRA projects that the proposal imposes one of the narrowest distributions of fee rate changes across members among the alternatives considered, as measured by the standard deviation of the rate of fee increase across members. Given this limited distributional impact, FINRA believes the proposal will preserve the same equitable and not unfairly discriminatory fee allocation that has long served as the foundation for FINRA's funding model and has been approved by the Commission.

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

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to the current baseline, and the alternatives FINRA considered in assessing how best to meet FINRA's regulatory objectives.

Regulatory Need

Based on an analysis of its funding sources, anticipated costs, and an assessment of future market activity, FINRA has determined that it will require additional revenues in order to meet its regulatory obligations in the future. FINRA anticipates that the absence of stable funding at the levels proposed here may have material negative impacts on its regulatory program and weaken investor protections. As it continues to rely on and deplete its reserves, FINRA may be unable to maintain its current capabilities at their current standards. In the absence of a fee increase, eventually FINRA will not be able to hire and retain staff with the appropriate expertise to conduct core regulatory activities (including market examination and surveillance, enforcement, regulation and rulemaking, examinations and credentialing, and providing transparency for markets, member firms and registered persons), or make the necessary investments over time in the technology needed to support these activities.

Economic Baseline

The baseline for this proposed rule includes FINRA's historical costs and revenues, the current schedule of fees assessed by FINRA, and the direct and indirect allocation of those fees across member firms, associated persons, third parties, and investors. The baseline also encompasses the scope of activities conducted by FINRA today to meet its mission, and FINRA's current ability to meet changing market activities and conditions through investment in staff, physical infrastructure and technology.

As discussed previously, as a not-for-profit organization, FINRA's operating principle is to target reasonable cost-based funding that allows it to appropriately fund its regulatory mission.[47] Between 2010 and 2019, FINRA's costs grew by a compound annualized growth rate (CAGR) of 1.7%, or 16% over the entire period.[48] Over the same period, reported costs increased by 42% for the industry,[49] while U.S. core inflation grew by 19%.[50]

At the same time, FINRA has seen capital markets grow in size and complexity, and an increase in its own regulatory responsibilities. Substantial increases in trading volume in listed equities, options and OTC equities (over 75% increase since 2015) and complexity of the securities markets (the number of registered securities exchanges significantly increased since 2011, from 13 to 25) have led to a more complex trading environment. This, in turn, has required new approaches to enhance surveillance and investigations by FINRA staff. New SEC regulations (an estimated 15 significant new rules in the broker-dealer space since 2010 based on a FINRA analysis), FINRA rulemaking designed to support federal initiatives (*e.g.,* crowdfunding, fixed income mark-up disclosure), and MSRB rules that require FINRA implementation have all increased FINRA's regulatory responsibilities substantially.

During this period, the SEC has increased reliance on FINRA as the ''first line supervisor'' for broker-dealers.[51] In response, FINRA continued to invest in its surveillance and examination programs. The SEC also created an updated oversight framework with substantially more inspections and reviews of FINRA, which in turn has required FINRA to commit significant new resources to support those inspections and reviews.

Over the last decade, FINRA has observed changes in the number of registered persons and member firms. Between 2009 and 2018, the number of registered member firms decreased from 4,720 to 3,607 (a change of approximately 26.3%) while the number of registered representatives decreased from 633,280 to 629,847 (a change of 0.5%).[52] Between 2009 and 2018, approximately 97% of the decrease in registered member firms came from small firms. Over the same period, the percentage of registered persons affiliated with small member firms dropped by a much smaller amount, from 12% to 10%. Despite the consolidation in the number of member firms, aggregate supervision costs fell minimally.

There are at least two drivers for this result. First, the exiting firms tended to require fewer supervisory resources because they were generally assessed as posing lower risks to investors and markets; higher-risk firms typically require more oversight. Relatedly, exiting firms generally conducted a smaller, simpler set of activities; larger, more complex firms typically require more oversight. And second, the number of registered persons remained fairly constant as persons from exiting

2003) (Order Approving File No. SR–NASD–2002–99) (''The Commission is satisfied that the NASD's proposed GIA is reasonably tailored to apportion fees based on the regulatory services the NASD provides''); Securities Exchange Act Release No. 67242 (June 22, 2012), 77 FR 38690, 38692 (June 28, 2012) (Order Approving File No. SR–FINRA–2012–023) (finding that ''trading in equity markets drives a significant portion of [FINRA's] regulatory costs, and therefore it is equitable to recover some of those costs from fees generated from trading activity''); and Order Approving SR–FINRA–2009–057, *supra* note 13, 74 FR at 62618 (''[T]he number of registered representatives is a significant factor that impacts FINRA's oversight responsibilities and thus is an equitable criterion for assessing PA fees'').

[47] In addition to the services FINRA provides in furtherance of its regulatory mission, FINRA also provides certain services on a contract basis to third parties. These contract service fees represent approximately 11% of FINRA's total revenues. Importantly, these revenues pay in full for the services rendered under the contracts, and FINRA's contract services are not funded with any of the regulatory revenue discussed in this filing.

[48] Based on figures drawn from FINRA's public Annual Financial Reports, which include FINRA subsidiaries. As noted above, *supra* note 11, FINRA Dispute Resolution was merged into FINRA Regulation at the end of 2015; if costs for the two remaining subsidiaries besides FINRA Regulation (the FINRA Investor Education Foundation and FINRA CAT, LLC) are excluded, FINRA's expense CAGR over the period would have been 1.5%.

[49] Based on FOCUS reporting.

[50] *See* CPI Inflation Calculator, Bureau of Labor Statistics, *available at https://data.bls.gov/cgi-bin/cpicalc.pl.*

[51] *See supra* notes 6 and 7.

[52] As FINRA notes when it publishes industry snapshots, FINRA regularly updates historical data series due to data revisions by reporting firms.

firms migrated to other firms, requiring FINRA regulatory resources to shift accordingly.

Despite the increased responsibilities and changes in its own oversight by the SEC, FINRA achieved the relatively low growth in its costs through a variety of mechanisms. Staffing generates the majority of FINRA's expenses and has been held relatively flat over the last decade. In that period, total compensation costs for FINRA employees engaged in carrying out its core business operations rose by 15% on a cumulative basis, compared to 24% for the average U.S. employee.[53] Further, FINRA has been successful in reducing non-compensation related expenses in recent years, with a 12% cumulative reduction across operating expenses (excluding technology) over the last 5 years, and a 25% decrease in non-recurring expenses.[54] FINRA's expenses have grown less rapidly than those of member firms. In addition, FINRA's proportional share of aggregate regulatory fees reported by member firms in total has fallen meaningfully.[55] Charts 2 and 3, attached in Exhibit 3, present these findings.[56]

Over the same period between 2010 and 2019, FINRA's regulatory and use-based revenues remained effectively flat, influenced by few fee increases and a relatively steady number of registered persons. FINRA's total revenues grew at a compound annual growth rate of 1.1% per year, or 10% between 2010 and 2019.[57] Between 2010 and 2013, FINRA increased regulatory fees by an aggregate amount of less than $22 million.[58] The period between 2013 and 2020 represents one of the longest windows in which FINRA has not raised regulatory fees. As a comparison, as illustrated in Chart 4, member firm revenues grew at a compound annual growth rate of 4.8% per year, or 52% between 2010 and 2019.

As a not-for-profit regulator, FINRA has also maintained a policy of returning revenues in excess of its operating costs through rebates. Over the same review period that is the focus of this analysis, 2010 through 2019, FINRA rebated regulatory fees to member firms five consecutive years between 2010 and 2014. The aggregate amount rebated was approximately $57 million.

Chart 5 provides a view of actual revenues and expenses between 2010 through 2019 and anticipated revenue and expenses for 2020–2024 if no changes to our fee structure are made.[59] Chart 5 also includes historical and projected ''excess reserves,'' meaning reserves above what the FINRA Board of Governors has determined to be an appropriate minimum level of at least one year of operating expenditures. As discussed above, FINRA has strategically relied on its reserves to help fund budget deficits in the past. From 2010 through 2019, FINRA used over $600 million of its reserves to fund operating losses, which on average amounted to 6.6% of FINRA's operating budget per year. While FINRA will continue to strategically draw on its reserves to support the phased implementation of this proposal, Chart 5 illustrates the projection that, without taking corrective action, FINRA will deplete its excess reserves in the coming years.

FINRA anticipates that revenues will remain at current levels without any changes in the fee structure. At the same time, FINRA assumes that future expenses will continue to grow at a reasonable pace of approximately 4% per year based on annual wage inflation and future capital initiatives.[60] In this scenario, revenues would increasingly fall behind anticipated costs. FINRA's reserves will continue to be used to cover the shortfall in the near-term, but the reserves will reach their minimum prudent level of one year of operating costs within three to four years based on current projections if no corrective action is taken.

FINRA notes that the anticipated retirement of its Order Audit Trail System (''OATS''), which is expected ultimately to be replaced by the Consolidated Audit Trail (''CAT''), does not result in an overall reduction in future expenses, but rather results in higher projected expenses for FINRA. Currently, FINRA incurs approximately $9 million per year in costs associated with its OATS program, including the costs to maintain the OATS system, host OATS data, and regulate compliance with OATS reporting rules. While FINRA's costs related to CAT implementation remain uncertain in several respects, FINRA reasonably projects such costs will exceed its current yearly OATS costs, due in large part to its need to develop a CAT reporting compliance program and integrate CAT data into its regulatory systems.

Specifically, because CAT reporting requirements are new, different from, and more granular than OATS reporting requirements, FINRA has made and will continue to make significant investments in its enhanced regulatory program to oversee CAT reporting compliance, including the technology (*e.g.,* surveillance patterns) and staff required to monitor for and enforce timely and accurate CAT data reporting. In contrast, OATS rules, infrastructure, and members' experience with compliance is mature, and only equities are reported to OATS, while equities and options are reported to CAT. These differences explain why FINRA's costs to regulate OATS reporting compliance are substantially less.

In addition to costs associated with its CAT reporting compliance program, FINRA must account for significant costs to integrate CAT data into its

[53] Average U.S. employee wage growth represents non-farm employee wage growth supplied by the Economic Policy Institute. FINRA employee compensation costs includes all FINRA staff exclusive of Technology staff.

[54] Technology costs are considered separately because they are often driven by special projects or capital expenditures, including initiatives designed to help control staffing costs in FINRA's core regulatory programs. FINRA notes that technology costs have risen at a greater rate over the period. Non-recurring expenses include capital initiatives and extraordinary initiatives. Technology costs, however, have risen by 22% cumulatively over the period—which is largely due to cloud hosting costs following FINRA's migration to the cloud, an increase in Technology maintenance support costs for newly developed applications and platforms, and expansion of FINRA's cybersecurity program. Cloud hosting costs are largely offset through the avoidance of large, periodic capital expenditures that would have been necessary without the migration.

[55] The number and amount of regulatory fees paid by FINRA member firms to other regulators depend upon other registrations and financial services provided.

[56] As with Chart 1, all of the charts discussed below are attached in Exhibit 3.

[57] Based on figures drawn from FINRA's public Annual Financial Reports, which include FINRA subsidiaries. As noted above, *supra* note 11, FINRA Dispute Resolution was merged into FINRA Regulation at the end of 2015; if revenues for the two remaining subsidiaries besides FINRA Regulation (the FINRA Investor Education Foundation and FINRA CAT, LLC) are excluded, FINRA's revenue CAGR over the period would have been 0.8%.

[58] Based on estimates made at the time the fee change occurred, and actual results incurred in that year or subsequent years may vary.

[59] The revenues and expenses presented in Chart 5—both historic and projected—do not include subsidiaries other than FINRA Regulation and FINRA Dispute Resolution, which was merged into FINRA Regulation at the end of 2015.

[60] This estimate is based on the following assumptions for FINRA and excludes the independent budgeting of all of FINRA's active subsidiaries other than FINRA Regulation—specifically, FINRA CAT, LLC and the FINRA Investor Education Foundation: (i) Wage inflation at an annual rate between 3% and 4%, consistent with the financial industry over the last five years; (ii) technology expense growth continues at recent levels due to: Capital investments seeking long-term efficiency gains for both FINRA and the industry, rising cloud hosting costs, maintaining technology labor competitiveness, and ongoing disaster recovery and cybersecurity requirements; and (iii) no material drop in regulatory efforts and associated costs for FINRA's regulatory programs. Taken together, these assumptions lead to an estimated growth rate consistent with the prior decade of expense growth realized by the industry.

regulatory systems. These include one-time costs to migrate regulatory systems into an environment that can interact with CAT data, with the potential for greater migration costs as a result of any future regulatory changes, such as under the Commission's recently proposed amendments to the CAT NMS Plan.[61] FINRA also is making significant investments in enhanced surveillance technology to account for and use CAT data in FINRA's oversight of various market integrity rules, as CAT includes expanded audit trail data for options and equities. Importantly, these costs are separate from and in addition to FINRA's obligation to contribute funding for the development, maintenance, and operation of the CAT system incurred by the CAT Plan Processor.[62]

As a result, while FINRA projects that OATS costs will be reduced and ultimately eliminated over the next several years, those cost reductions will be more than offset by FINRA's costs associated with ongoing efforts to implement and maintain a CAT reporting compliance program and integrate CAT data. In addition, although FINRA must incur costs to support both programs over the next several years until OATS retirement, FINRA believes it can manage these program budgets consistent with its assumption of approximately 4% overall future expense growth per year over the period.[63]

As described above, FINRA funds its regulatory and other related activities through a combination of regulatory and use-based fees. In aggregate, regulatory fees represent approximately 63% of these revenues and use-based fees represent approximately 37% of revenues. The specific fees that would be increased under this proposal represented 75% of these revenues in 2019.

All regulatory and use-based fees identified here are assessed directly to member firms, but FINRA understands that many firms shift at least some of the fees to others. For instance, it is regular practice among some clearing and trading firms to ''pass through'' the TAF to the underlying firm executing the trade. Further, FINRA understands that the executing firms commonly pass the TAF directly on to their customers. Typically, TAF fees are reflected on the confirmation statement received by customers. FINRA researched a sample of member firms, collectively representing 25% of total TAF revenues, and found confirmation disclosures for roughly two thirds of the sample reviewed that suggested that TAF is being passed through at either the clearing or executing firm level.

Similarly, FINRA understands that many firms regularly pass through to registered persons assessments such as the PA, registration fees, and examination fees. Registered persons also may seek to pass through these same fees to their customers indirectly as a part of their charges. FINRA understands that there may be differences in this practice across firms depending on each firms' business model. Competitive markets for the provision of brokerage and related financial intermediation services can limit the extent to which these fees can be passed through.

Regulatory fees are calibrated so that larger, more active and more dispersed member firms have higher fees, reflecting regulatory resource allocation. Use-based fees are designed to capture some of the costs associated with these core regulatory activities in addition to the direct and indirect costs of the service. For example, FINRA believes it is appropriate that registration and examination fees help defray the costs of regulating registered persons because member firms employing more persons require additional regulatory effort on FINRA's part. This approach is consistent with a structure where the fees paid are increasing with the size of the firm's revenues (GIA) and the amount of trading activity it conducts (TAF). In this manner, regulatory and use-based fees are designed in a cohesive way such that they should be evaluated in aggregate and not on a fee-by-fee or service-by-service basis.

The fee structure is also designed, purposefully, to account for diversity in firm size. Compliance and regulatory oversight naturally represent a larger relative cost to small firms. Because FINRA wants to prevent regulatory costs from creating a barrier to entry for smaller well-run, compliant firms, there is a level of cross-subsidization by larger firms of regulatory costs embedded in the fee structure currently in place.

This practice is appropriate for at least two significant reasons. First, it is important that retail investors have access to financial services provided in a way that serves them best. Some investors may prefer to engage registered persons associated with smaller firms. Second, larger firms obtain more benefits from well-regulated markets, relative to firm size. Under well-regulated markets, investors are more willing to trust financial intermediaries because they are confident that they are treated fairly in their access to securities markets and products. Greater participation in the financial markets by investors allow firms to grow larger and become more diversified, leading to cost savings and reduced risk through economies of scale and scope. The concentration in both retail and institutional investor activity at larger firms suggests that larger firms reap substantial benefits from strong regulation and should therefore contribute a substantial portion of the fee revenue to support this regulation. At the same time, the impact of misconduct at large firms impairs investor confidence more broadly than similar misconduct at smaller firms.

Chart 6 describes the estimated distribution of revenues from the fees covered in this proposal and the associated allocation of regulatory efforts by FINRA by the size of the firm, as defined in the FINRA By-Laws. Small member firms (firms with 150 or fewer registered reps) account for 90% of the firms in the industry, 10% of total registered persons, 50% of FINRA's total firm exam time, and 19% of FINRA's

[61] *See* Securities Exchange Act Release No. 89632 (August 21, 2020) (Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail to Enhance Data Security).

[62] Upon selection by the CAT NMS Plan Participants, FINRA created FINRA CAT, LLC as a distinct corporate subsidiary to serve as the CAT Plan Processor. In its capacity as the CAT Plan Processor, FINRA CAT, LLC is responsible for the development and operation of the CAT in accordance with the terms of the CAT NMS Plan, pursuant to an agreement between the CAT NMS Plan Participants and FINRA CAT, LLC. FINRA CAT, LLC is organized as a not-for-profit that operates on a cost basis and is not a source of revenue for FINRA. Pursuant to intercompany agreements, FINRA provides certain staff and resources to FINRA CAT, LLC so that FINRA CAT, LLC can carry out its obligations as the CAT Plan Processor. *See* Securities Exchange Act Release No. 85764 (May 2, 2019), 84 FR 20173 (May 8, 2019) (Notice of Filing and Immediate Effectiveness of SR–FINRA–2019–015). FINRA provides these staff and resources to FINRA CAT, LLC at cost, with FINRA CAT, LLC's portion of the cost of shared resources tracked and allocated completely back to FINRA CAT, LLC. As noted in FINRA's 2020 Annual Budget Summary and above, *supra* note 60, the FINRA CAT, LLC is accounted for separately from FINRA and the costs and revenues of FINRA CAT, LLC are not included in FINRA's budget.

Separately, FINRA and the other CAT NMS Plan Participants are collectively funding the costs to create, implement, and maintain the CAT in accordance with the CAT NMS Plan, and FINRA has relied on its balance sheet to pay its share of those costs to date. However, because the allocation of such CAT NMS Plan costs is the subject of ongoing discussion, FINRA has not included those CAT NMS Plan support costs in its budget projections. As a result, if the CAT NMS Plan Participants file a separate proposal to recover some portion of CAT NMS Plan costs through a direct CAT fee assessment on industry members, the effectiveness of such a filing would not reduce the amount that FINRA projects it needs to raise with this proposal to correct its structural deficit.

[63] To the extent any other FINRA systems are subject to retirement, FINRA will separately consider the projected budget impact of retirement for those systems.

revenues. Large firms, conversely, represent less than 5% of firms, over 80% of registered persons, 37% of FINRA's firm exam effort and approximately two thirds of regulatory revenues. The remaining portions of firm exam time and revenues are attributable to medium firms.

Chart 7 describes the estimated distribution of revenues from the fees covered in this proposal and the associated allocation of regulatory efforts by FINRA by the firm's business model. Here, business model captures the primary type of services provided the firm. The categories of capital markets and retail member firms account for 80% of the firms in the industry, 72% of total registered persons, 64% of FINRA's total examination time, and 36% of FINRA's regulatory revenues. The category of diversified firms, including most of the largest firms, accounts for approximately 5% of firms in the industry, almost 24% of total registered persons, over 27% of FINRA's total examination time, and 45% of FINRA's revenues.

Economic Impact

FINRA's fee proposal is intended to ensure that FINRA can continue to meet its mission of investor protection and facilitating well-functioning markets. This proposal preserves FINRA's ability to be a robust and effective regulator, protecting investors from manipulation, exploitation and other harm. Adequate funding allows FINRA to develop regulatory approaches that are more effective and efficient, and to revise its regulations through, among other ways, its robust retrospective reviews. Through appropriate funding, FINRA can continue to invest in technology, data, and analytics in support of its mission. FINRA will be better situated to adapt to changing markets, market behaviors, and any new responsibilities it may accrue. A stable and reliable funding program also permits member firms to better anticipate and plan for FINRA's fees. These benefits accrue to current and prospective investors, firms, issuers, and others participating in financial intermediation.

FINRA notes that academic literature has provided evidence of the linkage between strong regulation in securities markets and improved outcomes, including more trading, lower transaction costs, and greater investor participation in the markets.[64] Bruggeman, et al. [2018] study the impact of differences in State regulation on OTC stocks. They find that firms issuing in the OTC market subject to stricter regulation are more liquid and are subject to lower ''crash risk.'' Silvers [2016] studies the impact of SEC enforcement action against foreign cross-listed issuers. He shows evidence that other cross-listed issuers (not cited by the SEC) experienced positive returns, suggesting that increased regulatory attention increases valuation. Finally, Christensen et al. [2019] study the impact of the introduction of the European Union's Market Abuse Directive and MiFID. The study concluded that these initiatives designed to enhance investor protections have led to higher household ownership of equities.

The proposal would implement fee changes that would be assessed directly to member firms. The fee increases are designed to maintain the current distribution of fees allocated across member firms. FINRA based the proposed fee distribution across member firms on the assumption that the activities of the firms remained constant. Under this assumption, approximately 74% of the fee increase would be borne by large firms, 13% by medium firms, 12% by small firms (excluding firms of 10 or fewer registered persons), and the remaining 1% by micro firms (firms of 10 or fewer registered persons).

Chart 8 shows the aggregate anticipated increase in fees for the average firm across the period 2020–2024 and the breakdown across the fee categories covered by the proposed rule. Charts 9 through 11 describe the year-over-year fee increase for 2022, 2023 and 2024 respectively by fee type and firm size category (note that there is no proposed fee increase in 2020 or 2021). These charts demonstrate that the increase in fees remains consistently allocated across similarly sized firms in each calendar year, with the bulk of the fee increase occurring in the later years of the proposal. Taken together, these charts demonstrate that the fee increases in the GIA, TAF, PA, registration, and qualification examination fees are designed to allocate the growth in fees in an equitable manner both overall and within each calendar year of their phase-in, all else held equal, by maintaining a consistent fee growth impact across firm group sizes.

Similarly, Chart 12 shows the total fee increase and breakdown across fee category by member firm business model, holding constant the activities of the firm for the aggregate increase over the period 2020–2024. Approximately 76% of the fee increase is anticipated to be borne by diversified and retail firms, with the remaining 24% distributed relatively evenly across trading, capital markets and clearing firms. As with our analysis of the proposed fee increases by firm size, Charts 13 through 15 show the annual fee increases by fee category and business model for the years 2022, 2023 and 2024 respectively. Here, as well, the charts demonstrate that the anticipated fee increases by category are designed such that the increase in fees remains similar among firms with similar business models year-by-year, all else held equal.

While material, the FINRA fees subject to this proposal represent a very small dollar amount relative to industry activity. Holding industry revenues at 2019 levels, FINRA's regulatory, registration, and qualification examination fees in that year represented approximately 0.16% (16 basis points) of industry revenues as reported in FOCUS reports. When the proposed fee changes are fully adopted, FINRA estimates that these fees would represent approximately 0.22% (22 basis points) of 2019 industry revenues, assuming no FOCUS revenue growth for member firms over that time period. Further, the amount of the fee increase borne by member firms depends on the extent to which they can and do shift the burden to their associated persons and customers.

To better understand the impact of the proposed fee increases across member firms within each firm size category, FINRA analyzed the expected distribution of fee increases for all existing firms under the proposed fee structure, based on the expected rate of dispersion. Dispersion is a way to compare the anticipated growth rate in fees across a range of firms. Lower dispersion is associated with a higher degree of consistency in terms of the impact of the proposed fee increases, and can be interpreted as more firms in a given group experiencing similar rates of growth. By seeking to limit dispersion, the proposal is effectively limiting the potential for inequitable treatment across member firms. This approach reduces the potential for the proposed fee increase to create unintended impacts on the provision of financial services by member firms and the business models adopted by them.

[64] *See, e.g.,* U. Bruggeman, A. Kaul, C. Leuz, C. and I. Werner, *The Twilight Zone: OTC Regulatory Regimes and Market Quality,* The Review of Financial Studies, 31, no. 3 (2018), 898–942; Roger Silvers, *The Valuation Impact of SEC Enforcement Actions on Nontarget Foreign Firms,* Journal of Accounting Research, 54, no. 1 (2016), 187–234; and H. Christensen, M. Maffet, and L. Vollon, Securities Regulation, *Household Equity Ownership, and Trust in the Stock Market,* Review of Accounting Studies, 24, no. 3 (2019), 824–859.

FINRA's analysis examines the level of dispersion based on the CAGR of the expected fee increase. CAGR is measured in this analysis relative to the fee categories impacted by this proposal. CAGR provides a standard metric to compare the relative impact of the fee increases within and across subgroups. Because the number of registered persons, trading activity and resulting aggregate fee dollar amounts vary significantly across firms and firm sizes, benchmarking to CAGR permits FINRA to identify a fee schedule that most closely compares the magnitude of the distribution across firms.

Charts 16 through 19 provide a view on the distribution of fee increases within each member firm size group. These charts also report the median increase in regulatory fees, along with registration and qualification examination fees, that are the subject of this proposal over the full period 2020 through 2024 by firm size. Within the charts, each of the four central bars represents one standard deviation from the median, so that the two most central dark blue bars together would theoretically represent approximately 67% of all firms evaluated (plus or minus one standard deviation) and approximately 95% of firms evaluated should be represented under the four most central dark blue and mid-blue bars (plus or minus two standard deviations) presented in the charts.

While it is not feasible to eliminate the possibility that member firms will experience a rate of fee growth that is outside of the two standard deviation range, FINRA sought to limit the number of firms falling into this category when structuring this fee increase. These charts demonstrate that the proposal significantly limits the number of firms that fall beyond two standard deviations from the median increase. In particular, the proposal limits those firms that would be expected to experience a materially higher fee increase than the median (as defined by two standard deviations). For the entire population of member firms, FINRA estimates that no firm would experience a fee increase greater than two standard deviations from the median increase. In other words, no firm would be expected to bear an unduly high fee increase relative to the entire population of all firms (as defined by greater than two standard deviations).[65]

Based on this analysis, FINRA concludes the following:

• For micro firms, the median firm would anticipate an annual increase in fees of 3.9%, translating to a dollar increase of $642. Approximately two-thirds of these firms would experience an annual increase between 2.4% and 5.5% between 2020 and 2024. Holding revenues constant at 2019 levels, regulatory fees would increase from 0.21% to 0.27% of FOCUS reported revenues on average. This group includes 1,671 firms and represents 47.7% of all FINRA members.

• For other small firms, the median firm would anticipate an annual increase in fees of 6.2%, translating to a dollar increase of $6,200. More than 80% of these firms would experience an annual increase in fees between 5.3% and 7.1% between 2020 and 2024. Holding revenues constant at 2019 levels, regulatory fees would increase from 0.22% to 0.30% of FOCUS reported revenues on average. This group includes 1,470 firms and represents 42.0% of all FINRA members.

• For medium firms, the median firm would anticipate a 6.6% annual increase in fees, translating to a dollar increase of $73,000. More than 80% of these firms would experience an annual increase between 5.6% and 7.6% between 2020 and 2024. Holding revenues constant at 2019 levels, regulatory fees would increase from 0.18% to 0.25% of FOCUS reported revenues on average. This group includes 193 firms and represents 5.5% of all FINRA members.

• For large firms, the median firm would anticipate a 6.4% annual increase in fees, translating to a dollar increase of $293,000. Approximately 90% of these firms would experience an annual increase between 5.5% and 7.4% between 2020 and 2024. Holding revenues constant at 2019 levels, regulatory fees would increase from 0.15% to 0.20% of FOCUS reported revenues on average. This group includes 167 firms and represents 4.8% of all FINRA members.

To better understand the anticipated year-over-year impacts associated with the proposal, Charts 20 through 22 describe the dispersion in the annual growth rate for each year in which fees will be raised, segregated by firm size category. These charts demonstrate that dispersion remains fairly constant across calendar years covered by the proposal. Although there is some variation across the firm size groupings, a simple average of the four groupings leads to an estimate that: 78% of member firms would be expected to experience a fee increase within one standard deviation from the median increase in 2022, 76% of member firms would be expected to experience a fee increase within one standard deviation of the median fee increase in 2023, and 73% of member firms would be expected to experience a fee increase within one standard deviation of the median fee increase in 2024. FINRA believes that these charts demonstrate a high rate of consistency around the median expected fee increase and illustrate how the proposal will preserve the existing equitable and fair distribution of fees across FINRA's member firms.

FINRA notes that Charts 16 through 22 illustrate a wider relative range of dispersion amongst micro firms. Chart 16 also denotes a lower expected median fee increase for micro firms relative to other, larger firm types. This is due to the minimum GIA fee being held constant, rather than increasing along with the general GIA tiered fee schedule. Because more than half of micro firms were only subject to the minimum GIA fee in 2019, the median fee increase for micro firms will be lower relative to other firm sizes, and the range of outcomes within this grouping contains greater variance as select micro firms will be subject to the increase in GIA while others will not. FINRA believes that the resulting fee structure remains fair and equitable; moreover, maintaining the minimum GIA at current levels fosters investor choice and limits the impact of fees on the dimension of competition, as discussed above.

As part of its analysis, FINRA also considered the broad potential impacts on competition under this proposal. The analysis considers the impact across all FINRA member firms, across FINRA member firms based on size or business model, and between FINRA member firms and other financial service providers.

FINRA does not anticipate that the proposal will materially impact competition among member firms. The proposal is designed to maintain the current funding model and the relative allocation of fees across its core regulatory and use-based categories. In other words, each of the affected fees would increase in a commensurate manner relative to the fees charged under the existing framework; no individual fee would be raised such that it may create unintended hardships for

[65] Only 13 firms would be anticipated to experience an increase of more than two standard deviations relative to their peer group by size. The bulk of these firms have ten or fewer registered persons and are compared to other firms within the micro firm size category, which is the size grouping with the widest rate of dispersion given more significant variability in micro firm business models. The highest expected CAGR resulting from the fee increase for these firms would be 8.4%.

some firms and benefit others. Implementation of the proposal would not require significant system or process changes by firms.

Similarly, FINRA does not anticipate that the proposal will materially impact competition across member firms of different sizes or business models. The analysis of distributions within firm size does indicate that firms may anticipate some differences in fee increases based on the services they provide and the way they provide those services. But, as designed, the proposal maintains the relative allocation of fees across firm size and business model, meaning the proposal is designed to preserve a consistent rate of growth in fee increases across firm size and business model. As noted above, this approach is intended to limit the unintended impact that any specific fee change may create hardships for some firms and benefit others. Further, the approach maintains the current approach for cross-subsidization of regulatory fees between member firms of different size and between regulatory and use-based fees.

FINRA can identify two potential impacts of this proposal on the competition between its member firms and other providers of financial services. Although FINRA anticipates that these increases are calibrated to limit their impact on individual member firms, at the margin some member firms may find these increases material to their business. Further, where firms may have the ability to provide similar services, or a subset of services, without registration with FINRA, increased costs may increase the likelihood that these firms drop their FINRA registration in favor of the alternative business model. Based on the information available to it today, FINRA does not have an accurate measure of the number of member firms that may choose to deregister as a result of this proposal.[66]

The proposal may have an additional impact on competition in this dimension. As discussed above, strong and effective supervision and regulation of securities markets has been shown to increase investor confidence in the fairness of the market. This has been measured by an increase in household participation in the securities markets, more available liquidity, and higher securities valuations. Given the presence of close substitutes to broker-dealers for retail clients—*e.g.,* investment advisory services, issuers selling directly to the public, or certain market-linked insurance products—it may be reasonable to expect that effective supervision by FINRA may create a positive externality to those competitors. That is, increased confidence by retail investors due to FINRA's activities may increase business opportunities, lower transactional costs, or otherwise benefit non-FINRA member competitors, including instances where investors do not recognize these competitors are not supervised by FINRA.

Alternatives Considered

In developing this proposal, FINRA considered several options. First, FINRA considered making the fee changes effective immediately and not deferring the initial implementation to 2022. FINRA rejected this alternative because it believed it would be important to provide member firms adequate time to plan for the proposed fee increase while implementing other significant regulatory changes, including Regulation BI. Further, FINRA is cognizant that there is significant uncertainty in markets and the general economy during the global pandemic related to the coronavirus disease (COVID–19). Thus, increasing fees at this time may impose a greater burden.

Similarly, FINRA considered waiting to submit this proposed rule change until closer to when the proposed fee increases are scheduled to take effect in 2022, or pursuing separate filings for each year of the proposed fee increases between 2022 and 2024. Based on feedback from members of FINRA's advisory committees and other industry consultations that additional time and clarity would permit member firms to better plan for the proposed package of fee increases over multiple budget cycles, FINRA determined to move forward now with its current projections. As noted above, FINRA will continue to evaluate its financial condition during this period and make its financial information transparent to the public through its regular published reports. If FINRA's structural financial deficit is materially reduced during this period, or if key assumptions change, FINRA would submit a new filing to further defer the proposed fee increases or consider other modifications as appropriate.

FINRA also considered delaying the implementation of the fee increase beyond 2022. As noted above, FINRA is cognizant of the current uncertainty in markets. But the same market conditions that may create challenges for member firms also impact FINRA. Market volatility has negatively affected FINRA's reserves portfolio, similar to many investors. This limits FINRA's flexibility in relying on its reserves to cover funding gaps and indicates the need for stable funding as soon as practicable. Further, FINRA notes that investor protections are of vital importance, particularly in times of market turmoil where FINRA has seen an increase in customer complaints, regulatory actions against fraud, and increased resources for surveillance.[67] Impairing FINRA's ability to meet its mandate at this time may have material negative implications for investors and the financial markets. Taking these concerns into account, FINRA believes that the most prudent course of action is to delay implementation until 2022, but no further.

Finally, FINRA considered altering the mix of fees as part of this proposal. Some examples of approaches considered included placing greater weight on fees associated with registered persons, placing greater weight on trading-related fees, and reducing the level of cross-subsidization between large and small member firms. In each of these scenarios, the total amount raised in the proposal would have remained constant, but how the increases would be distributed across member firms would differ. Each scenario had associated with it a shift in the burdens based on firm size or business model. FINRA believes that these alternatives did not yield a more equitable fee mix. As a result, FINRA rejected these alternative formulations because the proposed approach maintains the current equitable structure, provides member firms with greater consistency and predictability in expected fees and the potential for complex impacts on competition inherent in the alternatives. FINRA believes that an overall proportional fee increase that maintains the current distribution of fees imposes the least aggregate impact on market participants and on the competition between them.

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

Written comments were neither solicited nor received.

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)

[66] FINRA notes that because of the time lapse between proposal, adoption and implementation of fee increases, combined with changing business environments over time, it is difficult to reliably estimate the number of firms that might have exited historically because of previous fee increases.

[67] In the first quarter of 2020, FINRA saw an increase in alerts generated through its market surveillance of over 250% compared to the same quarter in 2019.

of the Act[68] and paragraph (f)(2) of Rule 19b–4 thereunder.[69] 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.* Please include File Number SR–FINRA–2020–032 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number SR–FINRA–2020–032. 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 website (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule 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 website 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 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–FINRA–2020–032 and should be submitted on or before November 10, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[70]

J. Matthew DeLesDernier,

Assistant Secretary.

[FR Doc. 2020–23141 Filed 10–19–20; 8:45 am]

BILLING CODE 8011–01–P

[68] 15 U.S.C. 78s(b)(3)(A).

[69] 17 CFR 240.19b–4(f)(2).

[70] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–90183; File No. SR–EMERALD–2020–09]

Self-Regulatory Organizations; MIAX Emerald, LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend Its Fee Schedule To Adopt Application Programming Interface (''API'') Testing and Certification Fees and Network Connectivity Testing and Certification Fees

October 14, 2020.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on October 1, 2020, MIAX Emerald, LLC (''MIAX Emerald'' or ''Exchange''), filed with the Securities and Exchange Commission (''Commission'') a proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. 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

The Exchange is filing a proposal to amend the MIAX Emerald Fee Schedule (the ''Fee Schedule'') to establish Application Programming Interface (''API'') Testing and Certification fees and Network Connectivity Testing and Certification fees.

The text of the proposed rule change is available on the Exchange's website at *http://www.miaxoptions.com/rule-filings/emerald,* at MIAX's principal office, and at the Commission's Public Reference Room.

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange 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. The Exchange 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

The Exchange proposes to amend the Fee Schedule to establish API Testing and Certification fees for Members[3] and non-Members and Network Connectivity Testing and Certification fees for Members and non-Members. MIAX Emerald commenced operations as a national securities exchange registered under Section 6 of the Act[4] on March 1, 2019.[5] The Exchange adopted its transaction fees and certain of its non-transaction fees in its filing SR–EMERALD–2019–15.[6] In that filing, the Exchange expressly waived, among other fees, API Testing and Certification fees and Network Connectivity Testing and Certification fees, both for Members and non-Members, in order to provide an incentive to prospective Members and non-Members to connect to MIAX Emerald as soon as possible. At that time, the Exchange waived API Testing and Certification fees and Network Connectivity Testing and Certification fees for the Waiver Period[7] and stated

[3] ''Member'' means an individual or organization approved to exercise the trading rights associated with a Trading Permit. Members are deemed ''members'' under the Exchange Act. *See* Exchange Rule 100 and the Definitions section of the Fee Schedule.

[4] 15 U.S.C. 78f.

[5] *See* Securities Exchange Act Release No. 84891 (December 20, 2018), 83 FR 67421 (December 28, 2018) (File No. 10–233) (order approving application of MIAX Emerald, LLC for registration as a national securities exchange).

[6] *See* Securities Exchange Act Release No. 85393 (March 21, 2019), 84 FR 11599 (March 27, 2019) (SR–EMERALD–2019–15) (Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Establish the MIAX Emerald Fee Schedule).

[7] ''Waiver Period'' means, for each applicable fee, the period of time from the initial effective date of the MIAX Emerald Fee Schedule until such time

Continued