



May 15, 2008

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: SR-FINRA-2008-011: Proposed Rule Change to Amend Trade Reporting Structure and Require Submission of Non-Tape Reports to Identify Other Members for Agency and Riskless Principal Transactions

Dear Ms. Morris:

The Securities Industry and Financial Markets Association¹ (“SIFMA”) appreciates the opportunity to comment on the Financial Industry Regulatory Authority’s (“FINRA”) proposal to amend the trade reporting rules for over-the-counter (“OTC”) equity securities, and to require the submission of non-tape reports related to certain riskless principal and agency transactions.² SIFMA commends FINRA for its willingness to consider modifications of its trade reporting rules and, subject to the comments below, supports the proposed “executing party” reporting model. As discussed below, while we appreciate and support efforts to enhance FINRA’s audit trail and surveillance capabilities, we believe that these efforts should be coordinated with similar efforts by other self-regulatory organizations (“SROs”) to ensure that they are implemented as efficiently as possible. Therefore, we urge the Securities and Exchange Commission (“SEC” or “Commission”) and FINRA to defer consideration of this aspect of the OTC Reporting Proposal pending further collaboration among the SROs in this area.

¹ The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA’s mission is to promote policies and practices to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public’s trust and confidence in the markets and the industry. SIFMA works to represent its members’ interests locally and globally. It has offices in New York, Washington, D.C., and London, and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. (More information about SIFMA is available at: www.sifma.org.)

² Exch. Act Rel. No. 57681 (Apr. 17, 2008); 73 Fed. Reg. 22186 (Apr. 24, 2008) (“OTC Reporting Proposal”).

Executing Party OTC Trade Reporting Structure

Current NASD OTC trade reporting rules are unnecessarily complex and have become increasingly obsolete in light of the changes in the markets. The current rules require that: (i) in transactions between two market makers, the sell-side market maker reports the trade; (ii) in transactions between a market maker and non-market maker, the market maker reports the trade; (iii) the sell-side reports transactions involving two non-market makers; and (iv) the member reports transactions between a member and either a non-member or a customer.³ As FINRA points out in the OTC Reporting Proposal, the trade reporting structure can result in confusion about who has reporting responsibility, delays in reporting trades, and the double-reporting of trades.⁴ In addition, FINRA appropriately notes that, since the effectiveness of Regulation NMS of the Securities Exchange Act of 1934 (“Exchange Act”), members have been required to submit trade reports with appropriate modifiers reflecting the use of certain exceptions and exemptions from Rule 611 of the Exchange Act.⁵ This information may not be readily known to the member with the reporting obligation if it is not the executing broker for the transaction.⁶

The OTC Reporting Proposal is a much simpler model for effectively reporting trades. The proposal would modify the OTC equity trade reporting rules so that, for transactions between members, the executing party would report a trade to FINRA. FINRA proposes to define the executing party as the member that (i) receives an order for handling or execution or is presented an order against its quote; (ii) does not subsequently reroute the order; and (iii) executes the transaction.⁷ FINRA also has proposed that, in those limited circumstances where both members may satisfy the definition of an “executing party” in a transaction (*e.g.*, telephone and other manually negotiated trades), the sell-side member shall report the transaction unless the two firms agree otherwise and the sell-side member firm contemporaneously documents such agreement.⁸ Transactions between members and non-members would continue to be reported by members.⁹ We believe that these approaches represent workable standards for clearly identifying the member with the responsibility for reporting a transaction.

³ See NASD Rules 4632(b), 4632A(b), 4632C(b), 4632E(b), and 6620(b).

⁴ OTC Reporting Proposal at 22186.

⁵ NASD Rule 4632C(a)(5)(C); *see also*, FINRA Notice to Members 07-23, NASD Trade Reporting Requirements Related to Regulation NMS (May 2007).

⁶ OTC Reporting Proposal at 22186.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.* at 22187. We assume that TRF participants that are not FINRA members (*e.g.*, Canadian broker-dealers that are not FINRA members) would not have trade reporting obligations under the executing party structure.

There are, however, a few questions raised by this aspect of the OTC Reporting Proposal that merit clarification. First, FINRA should clarify whether members that manually negotiate a trade (whether by telephone or electronic messaging) and that seek to modify the proposed sell-side reporting default for such trades may use a previously executed Attachment II or other agreement to satisfy the documentation requirement under the proposed rule. FINRA also should confirm that the member with the trade reporting obligation – whether the executing broker, sell-side broker, or as agreed upon by members negotiating manual trades pursuant to the rule – is responsible for timely and accurate trade reporting under the proposed trade reporting structure. In particular, where two members in a manual trade have properly documented an agreement as to which member is responsible for reporting a trade, the other member is not responsible for any reporting deficiencies with respect to the trade. Also, firms have asked for additional guidance on whether and how the proposed trade reporting structure will impact Section 31 fee processing and, if it does have an impact, what modifications will be required to ensure that Section 31 fees are charged to the appropriate member.

FINRA members will need adequate time to address certain programming and system issues raised by the “executing party” aspect of the OTC Reporting Proposal. For example, this proposal not only will require many members to change the trade reporting logic of their internal systems, it also will require various vendors used by members to change their trade reporting systems to recognize when a member is the executing party and therefore has reporting obligations. In addition, changes to the trade reporting rules may affect trade clearing processes because many members employ automatic give-up (“AGU”) and other agreements in both the trade reporting and clearing processes that may require modifications as a result of an executing party reporting structure. Also, an adequate period of testing will be necessary to ensure that firm and vendor reporting systems are reprogrammed correctly and operate effectively. Overall, SIFMA believes that FINRA should allow members approximately six months for agreement modification, system reprogramming, and testing. The six month period should commence after revised technical specifications (including for the TRF) and any associated FAQs for the executing party reporting structure have been published. The rule change should not become effective prior to the end of this period.

We also think that FINRA should reconsider certain aspects of the proposed phase-in of this component of the OTC Reporting Proposal. First, FINRA should clarify that its discussion of alternative trading systems (“ATs”) and electronic communications networks (“ECNs”) in the OTC Reporting Proposal applies only to systems that qualify as “exchanges” under Rule 3b-16 of the Exchange Act and that operate under Regulation ATS. There are other internal broker-dealer systems that may or may not fit within the traditional meaning of the terms ATS or ECN. However, such systems may be generically referred to as “ATs.” FINRA’s clarification of this point would eliminate potential confusion in the adoption of this rule change. Second, FINRA also should reconsider its proposal to implement the new trade reporting structure for trades effected on all ATs earlier than for trades otherwise effected by members.¹⁰ FINRA has explained that a shorter implementation period is appropriate for ATs because generally they

¹⁰ *Id.* at 22189.

are the reporting party for transactions executed on the ATS under current NASD rules.¹¹ However, some ATSs have elected instead to use alternative trade reporting methods under the NASD rules,¹² and will need to make additional system changes to accommodate the proposed rule change. Therefore, FINRA should modify its proposal so that ATSs that submit trade reports on behalf of their subscribers and identify their subscribers as the reporting parties, or that require their subscribers to report trades executed on the ATS, would be subject to the later of the two operative dates.

Non-Tape Reporting for Riskless Principal and Agency Trades

FINRA also has proposed a rule change that would require any member with the trade reporting obligation under FINRA rules that is acting in a riskless principal or agency capacity on behalf of one or more other members to submit non-tape report(s) to FINRA, as necessary, identifying any other members that are parties to the trade.¹³ Currently, because each trade report submitted to the tape generally allows only for the identification of two parties, such tape reports do not always identify all members involved in the trade. Such information can be included on non-tape reports, but not all members submit such non-tape reports.¹⁴

SIFMA supports efforts by FINRA to maintain a complete and accurate audit trail and to facilitate effective surveillance of the markets. However, we continue to believe that FINRA and other SROs should coordinate their efforts to update and revise their regulatory reporting requirements as an extension of the rule harmonization process currently underway.¹⁵ Simplifying and streamlining the regulatory reporting process will provide helpful audit trail information for SROs without requiring firms that are members of multiple SROs to incur inordinate costs and difficulties associated with complying with similar but distinct SRO reporting systems. SRO coordination in this area also will avoid unnecessarily heavy demands on firms' data handling and storage systems.¹⁶

¹¹ *Id.* at 22187. *See* NASD Rule 6130(c)(5)(A).

¹² *See* NASD Rules 6130(c)(5)(B) and (C).

¹³ OTC Reporting Proposal at 22187.

¹⁴ *Id.*

¹⁵ *See* Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA to Barbara Z. Sweeney, Office of the Corporate Secretary, FINRA (Nov. 16, 2007). Some firms have suggested that a cohesive surveillance structure based on OATS would be the most effective approach, and would allow members to leverage their existing OATS systems. Other members are uncertain as to whether OATS would be the optimal choice as a foundation for an industry-wide surveillance system. SIFMA would be happy to work with FINRA and the other SROs to explore this and other industry-wide surveillance system options.

¹⁶ SIFMA has formed a Regulatory Reporting Infrastructure Committee to address these issues on an industry-wide level, with a view towards moving toward a more uniform approach, if not a single reporting system, in order to reduce redundancies and inconsistencies, provide appropriate and necessary trade information to regulators, and reduce the time and resources required from firms. *Id.*

More specifically, FINRA should coordinate its riskless principal/agency non-tape reporting proposal with the New York Stock Exchange's ("NYSE") efforts to impose similar requirements on riskless principal trades effected under NYSE Rule 92. In this regard, we note that the Commission recently approved the NYSE's extension of the effective date for its Rule 92 amendments concerning riskless principal trade reporting under its Front End Systemic Capture System ("FESC") from May 14, 2008 to March 31, 2009.¹⁷ In doing so, the NYSE specifically noted that it would be premature to require firms to meet the FESC reporting requirements while FINRA and the NYSE are in the process of fully harmonizing their respective rules – including reviewing the possibilities for a uniform reporting standard for riskless principal transactions.¹⁸

SIFMA urges the Commission and FINRA to similarly defer consideration and approval of FINRA's proposed non-tape regulatory reporting proposal. A reasonable delay in consideration of the proposal would permit FINRA and the NYSE to collaborate with each other and the industry on a more uniform approach for regulatory reporting related to riskless principal and agency trades that would meet the needs of both regulators as efficiently as possible. In the interim, members with trade reporting obligations would be required to maintain information concerning counterparties to riskless principal or agency trades, and to provide that information to FINRA upon request within a reasonable period of time.

Although SIFMA strongly believes that the Commission and FINRA should defer consideration of the proposed non-tape regulatory reporting proposal, there are certain issues that FINRA should address should the Commission determine to approve the proposal. First, SIFMA agrees that end-of-day reporting will be necessary. Firms often do not know at the time they are executing an order whether, or how much, of the order ultimately will be deemed executed on a riskless principal basis. This would make it very difficult, if not impossible, for member firms to identify a trade as riskless principal for the purpose of real-time non-tape reporting.¹⁹ Although the description of the non-tape reporting aspect of the OTC Reporting Proposal explains that FINRA's 90-second reporting requirement would not apply to the submission of non-tape reports under the rule,²⁰ it also goes on to state that in certain circumstances "members must submit non-tape reports contemporaneously with trade execution" to qualify under IM-2110-2 (the "Manning" Rule).²¹ Should FINRA proceed with the rule as proposed, greater clarification will be necessary with respect to how the requirement to submit non-tape reports for Manning purposes will be reconciled with the proposed end-of-day riskless principal reporting under the OTC Reporting Proposal.

¹⁷ Exch. Act Rel. No. 57682 (Apr. 17, 2008), 73 Fed. Reg. 22193 (Apr. 24, 2008).

¹⁸ *Id.* at 22193.

¹⁹ SIFMA notes that the NYSE similarly will allow end-of-day information submission for its FESC reporting amendments to Rule 92 in recognition of this issue. *See* Exch. Act Rel. No. 56968 (Dec. 14, 2007), 72 Fed. Reg. 72432 (Dec. 20, 2007).

²⁰ OTC Reporting Proposal at 22188.

²¹ *Id.* at fn. 14.

Additional guidance also would be necessary in other areas. As noted above, firms are interested in how the OTC Reporting Proposal might impact the payment of Section 31 fees. For example, would non-tape reports providing more detail regarding the various parties to a transaction affect the processing of Section 31 fees? Similarly, would the requirement to submit non-tape reports identifying all members involved in a trade impact OATS matching requirements? Our comments above regarding the operative dates for ATSS and ECNs also apply with respect to this aspect of the OTC Reporting Proposal (*i.e.*, some ATSS may not be the reporting party for transactions on their systems and may not submit non-tape reports reflecting all parties to a trade).

Should the Commission determine to approve this aspect of the OTC Reporting Proposal, SIFMA recommends that it should not become effective prior to the successful implementation of the executing party trade reporting rules. More specifically, members will need approximately six months after the executing party structure has been implemented and revised technical specifications (including for the TRF) and any associated FAQs regarding the riskless principal/agency reporting rules have been published to make system changes necessary to comply with any new rules and to perform any necessary testing.

Conclusion

SIFMA appreciates this opportunity to address the issues raised by the OTC Reporting Proposal. SIFMA believes the proposed executing party trade reporting structure, including the modification for manually negotiated orders, will greatly simplify OTC equity trade reporting generally and will facilitate trade reporting under Regulation NMS in particular. Although SIFMA appreciates and supports FINRA's efforts to enhance its audit trail and surveillance capabilities, we urge the Commission and FINRA to defer consideration of the non-tape, regulatory reporting aspect of the OTC Reporting Proposal until FINRA has had more time to collaborate with the NYSE and the industry in developing an efficient, harmonized, market-wide regulatory reporting structure.

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If you have any comments or questions, please do not hesitate to contact me at 202.962.7300.

Sincerely,



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SIFMA

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