SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-95388; File No. S7-05-15]

RIN 3235-AN17

Exemption for Certain Exchange Members

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is re-proposing amendments to a rule under the Securities Exchange Act of 1934 ("Act" or "Exchange Act") that exempts certain registered brokers or dealers from membership in a registered national securities association ("Association"). The re-proposed amendments would replace the rule's de minimis allowance, including the exclusion therefrom for proprietary trading, with narrower exemptions from Association membership for any registered broker or dealer that is a member of a national securities exchange, carries no customer accounts, and effects transactions in securities otherwise than on a national securities exchange of which it is a member. The re-proposed amendments would create exemptions for such a registered broker or dealer that effects transactions off an exchange of which it is a member that result solely from orders that are routed by a national securities exchange of which it is a member to comply with order protection regulatory requirements, or are solely for the purpose of executing the stock leg of a stock-option order.

DATES: Comments should be received on or before September 27, 2022.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (https://www.sec.gov/rules/submitcomments.html); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-05-15 on the subject line; or

Paper Comments:

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

All submissions should refer to File Number S7-05-15. This file number should be included on the subject line if e-mail 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/proposed.shtml). Comments also are 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 am and 3 pm. Operating conditions may limit access to the Commission's public reference room. 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.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by e-mail.

FOR FURTHER INFORMATION CONTACT: Michael Bradley, Assistant Director, at (202) 551-5594; David Michehl, Special Counsel, at (202) 551-5627; Nicholas Shwayri, Special Counsel, at (202) 551-5667; Vince Vuong, Special Counsel, at (202) 551-3742; or Mark Sater,

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SUPPLEMENTARY INFORMATION:

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I. Introduction

Section 15(b)(8) of the Act[1] prohibits any registered broker or dealer from effecting transactions in securities unless it is a member of an Association or effects transactions in securities solely on an exchange of which it is a member.[2] Section 15(b)(9) of the Act[3] provides the Commission with authority to exempt any broker or dealer from Section 15(b)(8), if that exemption is consistent with the public interest and the protection of investors. Pursuant to the authority conferred by Section 15(b)(9), Rule 15b9-1 provides that any broker or dealer required by Section 15(b)(8) of the Act to become a member of an Association shall be exempt from such requirement if it is a member of a national securities exchange, carries no customer accounts, and has annual gross income derived from purchases and sales of securities otherwise than on a national securities exchange of which it is a member in an amount no greater than $1,000 (this

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1 15 U.S.C. 78o(b)(8).

2 Section 15(b)(8) applies to any security other than commercial paper, bankers' acceptances, or commercial bills. Id.

3 15 U.S.C. 78o(b)(9).

$1,000 gross income allowance is referred to herein as the "de minimis allowance").[4] Under Rule 15b9-1, the de minimis allowance does not apply to income derived from transactions for a registered dealer's own account with or through another registered broker or dealer (referred to herein as the "proprietary trading exclusion").[5] Accordingly, a registered dealer can rely on Rule 15b9-1 to remain exempt from Association membership while engaging in unlimited proprietary trading of securities on any national securities exchange of which it is not a member or in the off-exchange market,[6] so long as it is a member of a national securities exchange, carries no customer accounts, and its proprietary trading is conducted with or through another registered broker-dealer.

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4 17 CFR 240.15b9-1(a).

5 17 CFR 240.15b9-1(b). The current rule also states that the de minimis allowance does not apply to income derived from transactions through the Intermarket Trading System, and defines the term "Intermarket Trading System" for purposes of the rule. 17 CFR 240.15b9-1(b)(2) and (c).

6 "Off-exchange" as used herein means any securities transaction that is covered by Section 15(b)(8) of the Exchange Act that is not effected, directly or indirectly, on a national securities exchange. See 17 CFR 240.600(b)(45) (defining "national securities exchange"). Off-exchange trading includes securities transactions that occur through alternative trading systems ("ATSs") or with another broker or dealer that is not a registered ATS, and is also referred to as over-the-counter ("OTC") trading. The Commission previously proposed to amend Rule 15b9-1 in 2015. See Securities Exchange Act Release No. 74581 (March 25, 2015), 80 FR 18036 (April 2, 2015) ("2015 Proposing Release" or "2015 Proposal"). There, the Commission defined the term "off-exchange" differently, such that it applied only to transactions in exchange-listed securities that were not effected, directly or indirectly, on a national securities exchange. Id. at 80 FR 18037, n. 3. Here, the definition of "off-exchange" encompasses transactions that are not effected, directly or indirectly, on a national securities exchange in both exchange-listed securities and securities that are not listed on a national securities exchange, such as U.S. Treasury securities and OTC equity securities, in order to more closely align the definition with the full scope of securities transactions that are covered by Section 15(b)(8) of the Exchange Act.

The securities markets have evolved dramatically in the forty-plus years since the Commission adopted Rule 15b9-1. During that span, the securities markets have transformed from being floor-based to being mostly electronic, and registered dealers have emerged that engage in significant, computer-based, cross-market proprietary trading activity. Several proprietary trading firms that are registered dealers and exchange members are not members of an Association, in reliance on Rule 15b9-1. These firms may effect significant securities transaction volume elsewhere than on an exchange of which they are a member but are not subject to Association oversight.

Self-regulatory organization ("SRO")[7] regulation of each broker or dealer is dependent upon the broker or dealer's individual SRO membership status. Each SRO that operates an exchange has responsibility for overseeing trading that occurs on the exchange it operates. Because of this, SROs that operate an exchange possess expertise in supervising members who specialize in trading the products and utilizing the order types that may be unique or specialized within the exchange. This expertise complements the expertise of an Association in supervising its members' cross-exchange and off-exchange securities trading activity. Indeed, the Exchange Act's statutory framework places SRO oversight responsibility with an Association for trading that occurs elsewhere than an exchange to which a broker or dealer belongs as a member.[8]

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7 An SRO is defined, in relevant part, as "any national securities exchange, registered securities association, or registered clearing agency. . . ." 15 U.S.C. 78c(a)(26).

8 See Sections 15(b)(8), 15A, 17(d), 19(g) of the Act. 15 U.S.C. 78o(b)(8); 15 U.S.C. 78o-3; 15 U.S.C. 78q(d); 15 U.S.C. 78s(g). Under the self-regulatory structure, the SRO where a broker-dealer is registered conducts regulatory oversight and assumes responsibility for that oversight. For example, Section 19(g)(1) of the Act, among other things, requires every SRO to examine for and enforce compliance by its members and associated persons with the Act, the rules and regulations thereunder, and the SRO's own rules, unless the SRO is relieved of this responsibility pursuant to Section 17(d) or

Individual exchanges have expertise in regulating their markets and historically have monitored market activity specific to their own exchanges or have outsourced that function to a third party. The Financial Industry Regulatory Authority, Inc. ("FINRA"), the only Association currently, historically has overseen cross-exchange and off-exchange securities trading activity.[9] But brokers and dealers that are not FINRA members are not subject to FINRA's rules.[10]

As a result, when broker-dealer firms that are not FINRA members effect securities transactions otherwise than on an exchange of which they are a member, such as off-exchange or on exchanges where they are not a member (collectively referred to herein as "off-member-exchange"),[11] these firms are not all subject to the same set of exchange rules and interpretations

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Section 19(g)(2) of the Act. 15 U.S.C. 78q(d); 15 U.S.C. 78s(g). Section 17(d)(1) of the Act provides that the Commission, in allocating authority among SROs pursuant to Section 17(d)(1), shall "take into consideration the regulatory capabilities and procedures of the self-regulatory organizations, availability of staff, convenience of location, unnecessary regulatory duplication, and such other factors as the Commission may consider germane to the protection of investors, cooperation and coordination among self-regulatory organizations, and the development of a national market system . . ." 15 U.S.C. 78q(d)(1). Section 15A of the Act provides for the creation of national securities associations of broker-dealers, with powers to adopt and enforce rules to regulate the off-exchange market. 15 U.S.C. 78o-3. And as described above, Section 15(b)(8) of the Exchange Act further implements this construct of effective regulatory oversight by requiring Association membership of a broker-dealer unless it effects transactions solely on an exchange of which it is a member. 15 U.S.C. 78o(b)(8).

9 The National Futures Association ("NFA"), as specified in Section 15A(k) of the Act, also is registered as a national securities association, but only for the limited purpose of regulating the activities of NFA members that are registered as brokers or dealers in security futures products under Section 15(b)(11) of the Act.

10 See FINRA Rule 0140.

11 To be consistent with Rule 15b9-1, off-member-exchange securities trading must occur with or through another registered broker-dealer, such as, in the case of trading on an exchange where the firm is not a member, through a broker-dealer that is a member of the exchange.

of those rules, which can vary between exchanges. As discussed below,[12] there are regulatory service agreements ("RSAs") among exchange SROs and FINRA, which have provided benefits to SROs such as lower regulatory costs and have been a component of FINRA's cross-market regulatory program. Importantly, FINRA has the expertise regarding off-exchange trading, but under these RSAs, for non-FINRA members that trade off-exchange and are members of different exchanges, FINRA applies the rules of the different exchanges using the exchanges' interpretations of those rules. This can result in different interpretations and FINRA registration would promote consistent interpretations and efficiencies in enforcement and regulation with respect to this growing part of the market. The rise in electronic proprietary trading and the increasingly fragmented market where trading takes place across many active markets have put pressure on the status quo and persuaded the Commission of the need for there to be more consistent regulation of such trading.

In addition, SROs retain responsibility for regulatory oversight under the RSAs; however, RSAs are voluntary, privately negotiated agreements that can expire or be terminated, and accordingly, these agreements may not in the future provide the stability of FINRA oversight. Further, the Commission, of course, may bring enforcement actions, including pursuant to referrals made by SROs, to enforce compliance with the Exchange Act and applicable rules. But as is also discussed below,[13] the Exchange Act requires a robust layer of SRO oversight over broker-dealers in addition to the Commission's regulatory role. In light of the extent to which off-member-exchange proprietary trading occurs today, the Commission believes that the SRO

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12 See Section II.B infra.

13 See Sections II.A and II.B infra.

layer of oversight should be enhanced by ensuring, as mandated by Section 15(b)(8) of the Act, that an Association generally has direct, membership-based oversight over broker-dealers that effect securities transactions elsewhere than on an exchange where they are a member and the jurisdiction to directly enforce their compliance with Federal securities laws, Commission rules, and Association rules.

The Commission adopted Rule 15b9-1 several decades ago so that an exchange member's limited proprietary trading activity ancillary to its exchange activity – which, at that time, typically was a floor business conducted on a single national securities exchange – would not necessitate Association membership in addition to exchange membership.[14] The Commission deemed it an appropriate exercise of its statutory authority to subject such an exchange member to exchange-only SRO oversight. But as stated above and described below, the securities markets have transformed dramatically and have evolved to include significant, cross-market electronic proprietary trading as a primary business model, and firms engaging in such trading activity that are exempt from Association membership, including important transaction reporting requirements, by virtue of Rule 15b9-1. In this regard, the Commission previously proposed to amend Rule 15b9-1 in 2015.[15] After the 2015 Proposal, FINRA established a transaction reporting regime under which broker-dealers that are FINRA members must report U.S. Treasury securities transactions. Some broker-dealer firms that are not FINRA members are significantly involved in trading U.S. Treasury securities proprietarily but are not required to report these transactions since they are not FINRA members. Moreover, U.S.

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14 See infra note 60 and accompanying text (discussing the adoption of Rule 15b8-1, which was later renumbered to Rule 15b9-1).

15 See 2015 Proposing Release, supra note 6.

Treasury securities trading occurs entirely off-exchange, thus these non-FINRA members conduct their U.S. Treasury securities trading activities outside of the direct SRO oversight of any exchange and, since they are not FINRA members, outside of FINRA's direct jurisdiction despite the fact that FINRA is the SRO responsible for the off-exchange market.[16]

The evolution of the markets – since Rule 15b9-1 was adopted and since the Commission's proposed changes to Rule 15b9-1 in 2015 – presents a need to realign Rule 15b9-1 with the current market so that the regulatory scheme more appropriately effectuates Exchange Act principles regarding complementary exchange SRO and Association oversight in today's market, including Section 15(b)(9)'s mandate that any exemption from Section 15(b)(8) be consistent with the public interest and protection of investors. Accordingly, the Commission is re-proposing amendments to Rule 15b9-1 that would rescind the de minimis allowance and proprietary trading exclusion, which generally would require Association membership, pursuant to Section 15(b)(8) of the Act, for any registered broker or dealer that effects securities transactions elsewhere than on a national securities exchange of which it is a member, subject to narrowed exemptions from Section 15(b)(8)'s Association membership requirement that are applicable to trading activity that is ancillary to the registered broker's or dealer's trading activity on a national securities exchange of which it is a member.[17]

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16 See FINRA Rule 6730 – Transaction Reporting, Supplementary Material .07 - ATS Identification of Non-FINRA Member Counterparties for Transactions in U.S. Treasury Securities.

17 This proposal re-proposes, with certain modifications, the amendments to Rule 15b9-1 that the Commission proposed in 2015. See 2015 Proposal, supra note 6. The 2015 Proposal contains additional background information regarding the regulatory history in this area and Rule 15b9-1. See 2015 Proposal, supra note 6, 80 FR at 18036-45.

II. Background

A. Current Regulatory Framework

Self-regulation is a longstanding, key component of U.S. securities industry regulation.[18] All broker-dealers are required to be members of an SRO, which sets standards, conducts examinations, and enforces rules regarding its members.[19] The Exchange Act sets forth a framework for broker-dealer regulation that, in addition to Commission oversight, requires this layer of SRO oversight, pursuant to which SROs act as front-line regulators of their broker-dealer members.[20] Although the Exchange Act provides a limited and targeted exception to

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Comments received in response to the 2015 Proposing Release are available at https://www.sec.gov/comments/s7-05-15/s70515.shtml.

18 See Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256 (December 8, 2004) ("Concept Release Concerning Self-Regulation").

19 Id. (citing Section 15(b)(8) of the Act (15 U.S.C. 78o15(b)(8))). Congress historically has favored self-regulation for a variety of reasons, including that effectively regulating the inner-workings of the securities industry at the federal level was viewed as cost prohibitive and inefficient; the complexity of securities practices made it desirable for SRO regulatory staff to be intimately involved with SRO rulemaking and enforcement; and the SROs could set standards such as just and equitable principles of trade and detailed proscriptive business conduct standards. Id. (citing, generally, S. Rep. No. 1455, 73d Cong., 2d Sess. (1934); H.R. Doc. No. 1383, 73d Cong., 2d Sess. (1934); S. Rep. No. 1455, 73d Cong., 2d Sess. (1934)); see also id., 69 FR at 71257-58.

20 Broker-dealers registered with the Commission are subject to the Commission's jurisdiction and oversight and must comply with Commission rules applicable to registered broker-dealers. See, e.g., 15 U.S.C. 78o, 17 CFR 240.15a-6 – 240.15b11-1, and 17 CFR 240.17a-1 – 240.17a-25. Matters related to SRO actions or their broker-dealer members also may be referred to the Commission or subject to Commission review. See, e.g., 15 U.S.C. 78s(d) and 15 U.S.C. 78s(e). But the Exchange Act also requires that SROs enforce their members' compliance with the Exchange Act, the rules and regulations thereunder, and the SRO's own rules. See, e.g., Sections 6(b)(1), 19(g)(1), and 15A(b)(2) of the Act (15 U.S.C. 78f(b)(1), 78s(g)(1), 78o-3(b)(2)); see also Section 11A(a)(3)(B) of the Act (15 U.S.C. 78k-1(a)(3)(B)) (authorizing the Commission to require SROs to act jointly in planning, developing, operating, or regulating the national market system).

Association membership requirements for broker-dealers, its approach to effecting supervision is relatively uniform: broker-dealers must be members of the SROs that regulate the venues upon which they transact.[21] A related, overarching principle in the Exchange Act is that the SRO best positioned to conduct regulatory oversight should assume that responsibility.[22] Correspondingly, SRO oversight of an exchange's members and their trading on the exchange is primarily the responsibility of the exchange, whereas SRO oversight of other trading activity, such as off-exchange trading,[23] is primarily the responsibility of an Association.[24]

This framework is embodied by several Exchange Act statutory provisions. When the Exchange Act was adopted in 1934, the exchanges were the only SROs and were charged with regulating the activities of their broker-dealer members. Congress soon recognized, however, that the benefit of exchange regulation could be undermined by the absence of a complementary regulatory framework for the off-exchange market. Consequently, in 1938, the Maloney Act established the concept of and regulatory framework for Associations under Section 15A of the Exchange Act. The Maloney Act states in its preamble that its purpose is "[t]o provide for the establishment of a mechanism of regulation among over-the-counter brokers and dealers operating in interstate and foreign commerce or through the mails, to prevent acts and practices

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21 See 2015 Proposal, supra note 6, 80 FR at 18039.

22 See supra note 8.

23 See supra note 6.

24 References herein to "exchange" or "national securities exchange" are to a national securities exchange that is registered with the Commission pursuant to Section 6 of the Exchange Act. References herein to "broker" or "dealer" or "broker-dealer" are to a broker or dealer that is registered with the Commission pursuant to Section 15 of the Exchange Act.

inconsistent with just and equitable principles of trade, and for other purposes."[25] In 1964, Congress passed Section 15(b)(8) of the Exchange Act, which currently requires that a registered broker or dealer join an Association unless it effects transactions solely on an exchange of which it is a member.[26]

Additional statutory provisions contemplate coordination of broker-dealer oversight among SROs. Section 19(g)(1) of the Exchange Act requires every SRO to examine for and enforce compliance by its members and associated persons with the Exchange Act, the rules and regulations thereunder, and the SRO's own rules, unless the SRO is relieved of this responsibility pursuant to Section 17(d) or Section 19(g)(2) of the Act.[27] With respect to a broker or dealer that is a member of more than one SRO ("common member"), Section 17(d)(1) authorizes the Commission, by rule or order, to relieve an SRO of the responsibility to receive regulatory reports, to examine for and enforce compliance with the applicable statutes, rules, and

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25 See Pub. L. No. 75-719, 52 Stat. 1070 (1938).

26 As discussed in greater detail in the 2015 Proposal, Section 15(b)(8) as originally enacted, and Rule 15b9-1 as originally adopted by the Commission (which was Rule 15b8-1 at that time and later re-designated as Rule 15b9-1) provided for direct Commission oversight of broker-dealers that effected transactions off-exchange as an alternative to joining an Association. In 1983, Congress amended the Act to eliminate the direct oversight of broker-dealers by the Commission and affirmed the benefits of self-regulation of broker-dealers directly by an Association. See 2015 Proposal, 63 FR at 18039-41; see also 15 U.S.C. 78o(b)(8), as amended by Pub. L. No. 98-38, 97 Stat. 205, 206 (1983); H.R. Rep. No. 98-106, at 597 (1983) (citing a preference for self-regulation over direct regulation by the Commission and noting, among other benefits of self-regulation, that the National Association of Securities Dealers ("NASD"), FINRA's predecessor, had available a broader and more effective range of disciplinary sanctions to employ against broker-dealers than had the Commission).

27 15 U.S.C. 78q(d) and 78s(g)(2).

regulations, or to perform other specified regulatory functions.[28] Without this relief, the statutory obligation of each SRO would result in duplicative examinations and oversight of common members.[29] Section 17(d)(1) of the Act provides that the Commission, in allocating authority among SROs, shall "take into consideration the regulatory capabilities and procedures of the self-regulatory organizations, availability of staff, convenience of location, unnecessary regulatory duplication, and such other factors as the Commission may consider germane to the protection of investors, cooperation and coordination among self-regulatory organizations, and the development of a national market system . . . ."[30] Among the SROs to which oversight

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28 15 U.S.C. 78q(d)(1).

29 In the Exchange Act Amendments of 1975 (Pub. L. 94–29, 89 Stat. 97 (1975), the "1975 Amendments"), Congress recognized that, at the time, the allocation of self-regulatory responsibilities among SROs resulted in some cases in duplicative regulation of firms that were members of multiple SROs and varying standards, both in substance and enforcement, among SROs. S. Doc. No. 93–13 at 164–165 (1973). As a result, Congress adopted Section 17(d) of the Act, which provides the Commission with the authority to allocate regulatory responsibilities among SROs with respect to matters as to which, in the absence of such allocation, such SROs would share authority. 15 U.S.C. 78q(d).

30 15 U.S.C. 78q(d)(1). To implement Section 17(d)(1), the Commission adopted Rules 17d-1 and 17d-2 under the Act. 17 CFR 240.17d-1 and 17 CFR 240.17d-2. Rule 17d-1 authorizes the Commission to name a single SRO as the designated examining authority ("DEA") to examine common members for compliance with the financial responsibility requirements imposed by the Act, or by Commission or SRO rules. See Exchange Act Release No. 12352 (April 20, 1976), 41 FR 18808 (May 7, 1976). To address regulatory duplication in areas other than financial responsibility, including sales practices and trading practices, the Commission adopted Rule 17d-2 under the Act. See Exchange Act Release No. 12935 (October 28, 1976), 41 FR 49091 (November 8, 1976). Rule 17d-2 permits SROs to propose joint plans among two or more SROs for the allocation of regulatory responsibility with respect to their common members. 17 CFR 240.17d-2. The regulatory responsibility allocated among SROs only extends to matters for which the SROs would share authority, which means that only common rules among SROs can be allocated under Rule 17d-2. Under paragraph (c) of Rule 17d-2, the Commission may declare such a plan effective if, after appropriate notice and opportunity for comment, it finds that the plan is necessary or appropriate in the public interest and for the protection of investors, to foster cooperation and coordination among SROs, or to remove

responsibility is allocated pursuant to 17d-2 plans, FINRA, as the only registered Association currently, has coordinated with exchanges in the exercise of SRO oversight over broker-dealers that are common members of FINRA and the exchanges on which they trade securities.[31]

FINRA, however, is primarily responsible for exercising SRO oversight over broker-dealers' off-member-exchange securities trading activities, such as when broker-dealers effect securities transactions across markets that include exchanges where they are not a member or the off-exchange market.[32] In particular, FINRA regulates off-exchange trading of equities, fixed income (including U.S. Treasury) securities, and other products, and investigates and brings enforcement actions against members for violations of its rules, the rules of the Municipal Securities Rulemaking Board, and the Exchange Act and the Commission rules thereunder.[33] FINRA also conducts the vast majority of broker and dealer examinations,[34] and mandates

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impediments to and foster the development of a national market system and a national clearance and settlement system and in conformity with the factors set forth in Section 17(d) of the Act. Id. Commission approval of a plan filed pursuant to Rule 17d-2 relieves an SRO of those regulatory responsibilities allocated by the plan to another SRO.

31 See Staff of the Division of Trading and Markets, "Staff Paper on Cross-Market Regulatory Coordination," (Dec. 15, 2020) (available at https://www.sec.gov/tm/staff-paper-cross-market-regulatory-coordination) ("Cross-Market Regulatory Coordination Staff Paper"). Staff reports and other staff documents (including those cited herein) represent the views of Commission staff and are not a rule, regulation, or statement of the Commission. The Commission has neither approved nor disapproved the content of these staff documents and, like all staff statements, they have no legal force or effect, do not alter or amend applicable law, and create no new or additional obligations for any person.

32 See Pub. L. No. 75-719, 52 Stat. 1070 (1938). Although FINRA is the sole Association, the statute does not limit the number of Associations.

33 15 U.S.C. 78o-3.

34 Routine broker and dealer examinations are conducted by the exchange SROs as well, and the Commission staff oversees the examination efforts of all SROs. In addition, the Commission staff also conducts risk-based examinations of brokers and dealers.

broker and dealer disclosures.[35] FINRA also has developed rules and guidance tailored to trading activity,[36] and has developed surveillance technology and specialized regulatory personnel to provide surveillance, supervision, and enforcement of FINRA rules and the federal securities laws applicable to activity occurring off-exchange.[37] Further, FINRA has a detailed set of member conduct rules that apply to all activities of a FINRA member firm, whether on- or off-exchange.[38]

In addition, FINRA has rules that support a comprehensive public transparency regime with respect to off-exchange securities transactions. One element of this regime is the requirement that FINRA members report to FINRA all OTC Equity Security trades[39] and off-

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35 15 U.S.C. 78o-3. See, e.g., FINRA Rules 3130 (Annual Certification of Compliance and Supervisory Processes), 4120 (Regulatory Notification and Business Curtailment), 4530 (Reporting Requirements), 4540 (Reporting Requirements for Clearing Firms), 4560 (Short-Interest Reporting), and 6439 (Requirements for Member Inter-Dealer Quotation Systems).

36 See, e.g., FINRA Rules 5240 (Anti-Intimidation/Coordination), 5250 (Payments for Market Making), 5210.02 (Publication of Transactions and Quotations – Self-Trades), and 6140 (Other Trading Practices). Exchanges have similar rules. See, e.g., NYSE Rules 4560 and 6140; Nasdaq Rules 5240 and 5250.

37 See FINRA.org, FINRA 2021 Annual Financial Report, available at https://www.finra.org/sites/default/files/2022-06/2021-FINRA-Financial-Annual-Report.pdf (last visited July 22, 2022).

38 See FINRA Rule 2000 Series – Duties and Conflicts.

39 See FINRA Rule 6420(f) (defining "OTC Equity Security" to mean any equity security that is not an "NMS stock" as that term is defined in Rule 600(b) of SEC Regulation NMS; provided, however, that the term "OTC Equity Security" shall not include any Restricted Equity Security). See also FINRA Rule 6420(k) (defining "Restricted Equity Security" to mean any equity security that meets the definition of "restricted security" as contained in Securities Act Rule 144(a)(3)); 17 CFR 242.600(b) (defining "NMS stock" as any NMS security other than an option, and defining "NMS security" as any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options). FINRA members are

exchange NMS stock trades,[40] in connection with which FINRA has developed a detailed set of trade reporting rules.[41] This transaction information then becomes publicly available.[42] FINRA

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required to report transactions (other than transactions executed on or through an exchange) in OTC Equity Securities and Restricted Equity Securities to FINRA's OTC Reporting Facility ("ORF"). See FINRA Rules 6410 and 6610; see also FINRA Rule 6420(n) (defining "OTC Reporting Facility" as the service provided by FINRA that accommodates reporting for trades in OTC Equity Securities executed other than on or through an exchange and for trades in Restricted Equity Securities effected under Securities Act Rule 144A and dissemination of last sale reports).

40 See FINRA Rule 6110 and the FINRA Rule 6000 Series generally – Quotation, Order, and Transaction Reporting Facilities. FINRA operates two Trade Reporting Facilities ("TRFs"), one jointly with Nasdaq and another with the NYSE. The TRFs are FINRA facilities for FINRA members to report NMS stock transactions effected otherwise than on an exchange. See Exchange Act Release No. 54084 (June 30, 2006), 71 FR 38935 (July 10, 2006) (order approving the Nasdaq TRF); Exchange Act Release No. 55325 (February 21, 2007), 72 FR 8820 (February 27, 2007) (notice of filing and immediate effectiveness of a proposed rule change to establish the NYSE TRF). In addition, FINRA operates the Alternative Display Facility ("ADF") for NMS stocks, which is a FINRA facility for posting quotes and reporting trades governed by FINRA's trade reporting rules. See Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49821 (July 31, 2002) (order approving the ADF); see also Exchange Act Release No. 71467 (February 3, 2014), 79 FR 7485 (February 7, 2014) (order approving a proposed rule change to update the rules governing the ADF).

41 See FINRA Rule 6000 Series – Quotation, Order, and Transaction Reporting Facilities, supra note 40; and FINRA Rule 7000 Series – Clearing, Transaction and Order Data Requirements, and Facility Charges.

42 Pursuant to effective national market system plans which are also effective transaction reporting plans (as both terms are defined in Rule 600(b) of Regulation NMS), namely the Nasdaq UTP Plan and the CTA Plan, FINRA reports to the Securities Information Processors ("SIPs") information for off-exchange NMS stock transactions that are reported to FINRA's TRFs, and the SIPs in turn distribute the information in the public consolidated market data feeds. See Section VIII(a) of the CTA Plan and Section VIII.B of the Nasdaq UTP Plan. In addition, currently, Nasdaq UTP Plan Level 1 subscribers can obtain the OTC Equity Security transaction information that is reported to FINRA's ORF and disseminated under the FINRA - Trade Data Dissemination Service (TDDS). See UTPPlan.com, UTP Plan Administration Data Request Form, available at https://www.utpplan.com/DOC/UTP_Data_Feed_Request.pdf (last visited July 22, 2022) (stating that direct access subscribers may request FINRA OTC Data (FINRA OTC Equity Securities Rule 6400) as part of the Nasdaq UTP Plan Level 1 service).

also maintains the Trade Reporting and Compliance Engine ("TRACE") reporting system for fixed income securities.[43] FINRA introduced TRACE reporting requirements for U.S. Treasury securities transactions in 2017, which has enhanced the regulatory audit trail in that market.[44] FINRA publishes weekly aggregated transaction information and statistics on U.S. Treasury securities on its website.[45]

In contrast to FINRA, the regulatory focus of national securities exchanges, which are also SROs, is generally on trading by their members on their respective exchanges.[46] Exchanges

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43 See FINRA Rule 6700 Series.

44 See Securities Exchange Act Release No. 79116 (October 18, 2016), 81 FR 73167 (October 24, 2016) (File No. SR-FINRA-2016-027).

45 See FINRA.org, Treasury Aggregate Statistics, available at https://www.finra.org/finra-data/browse-catalog/treasury-weekly-aggregates (last visited July 22, 2022). The information is aggregated by security subtype: Bills, Floating Rate Notes (FRN), Nominal Coupons and Treasury Inflation-Protected Securities (TIPS). The data is further grouped into "ATS and Interdealer," "Dealer-to-Customer," and "Total" categories. For Nominal Coupons and TIPS, the report also shows remaining maturity and on-the-run/off-the-run groupings. See also FINRA Rule 6750 – Dissemination of Transaction Information, Supplementary Material .01(b). FINRA recently proposed to publish aggregated U.S. Treasury securities transaction information and statistics more frequently, such as on a daily basis. See Securities Exchange Act Release No. 95165 (June 27, 2022), 87 FR 39573 (July 1, 2022) (File No. SR-FINRA-2022-017).

46 Congress saw the codification of regulations requiring the registration of off-exchange brokers and dealers as "an essential supplement to regulation of the exchanges." H.R. Rep. No. 74-2601, at 4 (1936). In addition, in advance of the 1975 Amendments, Congress contemplated reforms to the regulatory structure of the securities markets in which an Association's role would be expanded, while exchanges would focus their regulatory activities on their respective markets: "the time has come to begin planning a framework which will guide the development of the self-regulatory system in the future. In the revised system, a single nationwide entity [an Association] would be responsible for regulation of the retail end of the securities business, including such matters as financial responsibility and selling practices, while each exchange would concentrate on regulating the use of its own trading facilities . . . the regulatory activities of the NASD (the only organization presently registered as a national securities association) would encompass many of the present regulatory activities of the NYSE and other exchanges over retail activities of their members. This 'expanded' NASD would have direct

generally monitor market activity specific to their own exchanges and have expertise in regulating unique aspects of their markets.[47] For example, exchange rules typically regulate, among other things, the opening and closing of trading on the exchange;[48] exchange order types and order handling;[49] member application processes and ongoing member requirements; [50] listings; [51] investigations, complaints, disciplinary action and the related appeals process;[52] as well as member conduct generally.[53] In many cases, exchange rules are similar to FINRA rules or incorporate FINRA rules by reference.[54]

In addition, exchanges have entered into 17d-2 plans that allocate to FINRA examination and enforcement responsibility relating to compliance by common members with Federal

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responsibility, subject to SEC oversight, for enforcing SEC rules and its own rules . . ." S. Doc. No. 93-13 at 16, 169 (1973). See also 2015 Proposing Release, supra note 6, 80 FR 18039 at note 28 and accompanying text. In 2007, the Commission approved changes that consolidated the member firm regulatory functions of the NASD, an Association, and NYSE Regulation, Inc., and changed the name of the combined entity to FINRA. See Exchange Act Release No. 56145 (July 26, 2007), 72 FR 42169 (August 1, 2007).

47 See Cross-Market Regulatory Coordination Staff Paper, supra note 31.

48 See, e.g., NYSE Rule 7.35 Series – Auctions.

49 See, e.g., Nasdaq Rule 4702 – Order Types and Nasdaq Rule 4703 – Order Attributes.

50 See, e.g., Cboe Rulebook Chapter 3 – TPH Membership, Registration, and Participants.

51 See, e.g., IEX Rulebook Chapter 14 - IEX Listing Rules.

52 Typically, exchange rules regarding investigations, complaints, disciplinary actions, and appeals apply to the conduct of members (and associated persons) for violations of exchange rules and federal securities laws and regulations that the exchange has jurisdiction to enforce. See, e.g., Cboe Rule 13.1; IEX Rule 9.110(a); MIAX Chapter X, Rule 1000; Nasdaq Rule General 5, 9110(d); and Nasdaq PHLX Rule General 5, Section 1.

53 See, e.g., NYSE Rules 2010 – 7470 – Conduct Rules.

54 See, e.g., NYSE Rules 4110 and 4140, and FINRA Rules 4110 and 4140; and Nasdaq General 9 (Regulation) (incorporating by reference various FINRA rules).

securities laws, Commission rules, and common exchange and FINRA rules, allowing the exchanges to focus on trading on their own markets. For example, under a 17d-2 plan for the allocation of regulatory responsibility relating to Regulation NMS rules, FINRA is responsible for overseeing and enforcing compliance with certain Regulation NMS rules by common members of FINRA and any exchange participant in the agreement, while each exchange retains responsibility for surveillance and enforcement with respect to trading activities or practices involving its own marketplace.[55] Most exchanges and FINRA also have entered into RSAs, which are privately negotiated agreements between two SROs whereby one SRO agrees to perform regulatory services on behalf of another SRO in exchange for compensation.[56]

In addition to regulatory coordination that occurs through 17d-2 plans and RSAs, SROs also coordinate regulatory efforts through forums provided by the Intermarket Surveillance Group ("ISG"). The ISG, created in 1981, is an international group of exchanges, market centers, and regulators that perform market surveillance in their respective jurisdictions.[57] The ISG's focus is regulatory information sharing and coordination for both domestic and foreign

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55 See, e.g., Exchange Act Release Nos. 63220 (November 2, 2010), 75 FR 68632 (November 8, 2010) and 63430 (December 3, 2010), 75 FR 76758 (December 9, 2010). In addition, generally, FINRA is the DEA for financial responsibility rules for exchange members that also are members of FINRA. See infra notes 227 - 228 and accompanying text (discussing DEAs). See also Cross-Market Regulatory Coordination Staff Paper, supra note 31 (stating that "FINRA serves as the Designated Regulation NMS Examining Authority ("DREA") and Designated CAT Surveillance Authority ("DCSA") for common exchange members that are also members of FINRA, and assumes certain examination and enforcement responsibilities for those members with respect to specified Regulation NMS rules (i.e., 606, 607, 611, 612 and 613(g)(2)), and for the cross-market surveillance, examination, investigation and enforcement of Rule 613 and the rules of the SROs regarding compliance with the CAT NMS Plan.").

56 See Cross-Market Regulatory Coordination Staff Paper, supra note 31.

57 See id.

regulators.[58] Pursuant to its charter, one of the ISG's purposes is "the coordination and development of programs and procedures designed to assist in identifying possible fraudulent and manipulative acts and practices across markets, where possible, particularly between markets which trade the same or related or derivative Financial Instruments[.]"[59]

B. Need for Amendment

The Commission originally adopted Rule 15b8-1 in 1965 (renumbered to Rule 15b9-1 in 1983 and generally referred to herein as Rule 15b9-1) to allow exchange specialists and other floor members to receive a portion of the commissions paid on occasional off-exchange transactions referred to other broker-dealers, up to a nominal amount.[60] The original version of Rule 15b9-1 included the de minimis allowance but not the proprietary trading exclusion. The Commission adopted the proprietary trading exclusion in 1976 to accommodate regional exchange specialists that, as part of their floor-based business, might have needed to lay off positions and hedge risk on the primary listing exchange through a member of that exchange.[61]

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58 See id.

59 See id.

60 See Qualifications and Fees Relating to Brokers or Dealers Who Are Not Members of National Security [sic] Association, Exchange Act Release No. 7697 (September 7, 1965), 30 FR 11673 (September 11, 1965) ("Qualifications and Fees Release"). The Commission stated: "Among the broker-dealers that are not members of a registered national securities association are several specialists and other floor members of national securities exchanges, some of whom introduce accounts to other members. The over-the-counter business of these broker-dealers may be limited to receipt of a portion of the commissions paid on occasional over-the-counter transactions in these introduced accounts, and to certain other transactions incidental to their activities as specialists. In most cases, the income derived from these activities is nominal." Id. at 11675.

61 See Extension of Temporary Rules 23a-1(T) and 23a-2(T); Adoption of Amendments to SECO Rules, Securities Exchange Act Release No. 12160 (March 3, 1976), 41 FR 10599 (March 12, 1976) ("Adoption of Amendments to SECO Rules"). In adopting the proprietary trading exclusion, the Commission indicated that an exchange floor broker,

These exchange specialists and floor brokers typically were members of a single exchange, and the circumstances under which they would trade proprietarily off-exchange were quite limited.[62] Taken together, the historical purpose of Rule 15b9-1's de minimis allowance and proprietary trading exclusion was to accommodate limited broker-dealer trading activities that were ancillary to a floor-based business on a single exchange while preserving the traditional role of the exchange as the entity best suited to regulate member conduct on the exchange.

Since that time, the securities markets have undergone a substantial transformation that has been driven primarily by rapid and ongoing evolution of technologies for generating, routing, and executing orders, and the impact of regulatory changes.[63] Today, trading in the U.S.

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through another broker or dealer, could effect transactions for its own account on an exchange of which it was not a member. Id. at 10600. The Commission noted that such transactions ultimately would be effected by a member of that exchange. In 1983, the Commission further amended Rule 15b9-1 to accommodate transactions effected through the new Intermarket Trading System linkage, and eliminated references to, and requirements under, the SECO Program. See SECO Programs; Direct Regulation of Certain Broker-Dealers; Elimination, Exchange Act Release No. 20409 (November 22, 1983), 48 FR 53688 (November 29, 1983) ("SECO Programs Release").

62 In the Special Study of the Securities Markets in 1963, the Commission described how regional exchange specialists reduced their exposure, including by offsetting positions on other exchanges. The Commission noted that "[s]pecialists on the Boston, Philadelphia-Baltimore-Washington, Pittsburgh, and Montreal stock exchange are in communication with each other by direct wires linking their floors and each may trade on the other exchanges at member rates" and "[s]pecialists who are sole members [of an exchange] also offset [their positions] with over-the-counter houses dealing in listed securities. Many of the offsetting transactions are done on the primary market, the NYSE, with the [specialist] buying or selling on that exchange as his needs dictate." Report of Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 88-95, at 935 (1963) ("Special Study"). The Commission believes that the business of regional exchange specialists was substantially the same when the proprietary trading exclusion in Rule 15b9-1 was adopted in 1976.

63 See Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3594 (January 21, 2010) (Concept Release on Equity Market Structure) ("Equity Market Structure Concept Release"), at 3594 ("Changes in market structure also reflect the

securities markets is highly automated, dispersed among myriad trading centers, and substantially more complex.[64] Trading is spread among a number of highly automated trading centers – 24 registered exchanges,[65] 33 ATSs that trade NMS stocks,[66] at least 2 ATSs that trade U.S. Treasury securities,[67] and nearly 200 OTC market-makers[68] – and the routing and re-routing of orders to multiple venues is common. Moreover, new types of proprietary trading firms have emerged, including those that engage in so-called high-frequency trading strategies. These firms tend to effect transactions across the full range of exchange and off-exchange markets, including ATSs. They also typically use complex electronic trading strategies and sophisticated

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markets' response to regulatory actions such as Regulation NMS, adopted in 2005, the Order Handling Rules, adopted in 1996, as well as enforcement actions, such as those addressing anti-competitive behavior by market makers in NASDAQ stocks.").

64 See Equity Market Structure Concept Release, supra note 63. See also 2015 Proposing Release, supra note 6.

65 There are 8 registered exchanges that only trade equities and 8 registered exchanges that only trade options. In addition, there are 8 registered exchanges that trade both equities and options.

66 See 17 CFR 242.300 (defining the terms "alternative trading system" and "NMS Stock ATS"). This data was compiled from Forms ATS-N filed with the Commission as of July 22, 2022, available at https://www.sec.gov/divisions/marketreg/form-ats-n-filings.htm.

67 See U.S. Dep't of the Treasury et al., Joint Staff Report: The U.S. Treasury Market on October 15, 2014 (July 13, 2015) (the "Joint Staff Report"). The Joint Staff Report noted that SEC rules applicable to ATSs do not apply to ATSs through which only government securities are traded, although such venues may voluntarily adopt such standards. Since the Joint Staff Report was issued, however, the Commission has proposed to amend Regulation ATS to include ATSs through which only government securities are traded. See Securities Exchange Act Release No. 94062 (January 26, 2022), 87 FR 15496 (March 18, 2022).

68 Nearly 200 brokers or dealers (excluding ATSs) have identified themselves to FINRA as market centers that must provide monthly reports on order execution quality under Rule 605 of Regulation NMS (list available at http://www.finra.org/industry/market-centers).

technology to generate a large volume of orders and transactions throughout the national market system.[69]

In fact, the large-scale proprietary trading that occurs in the securities markets today is not confined to equities and options. For example, there is significant automated proprietary trading in U.S. Treasury securities, which are not traded on any national securities exchange.[70] As noted in the Joint Staff Report, proprietary trading firms, or principal trading firms ("PTF(s)") as they are also called, account for a majority of trading and market depth in the electronic

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69 Many, but not all, proprietary trading firms are often characterized by: (1) the use of extraordinarily high-speed and sophisticated computer programs for generating, routing, and executing orders; (2) the use of co-location services and individual data feeds offered by exchanges and others to minimize network and other types of latencies; (3) the use of very short time-frames for establishing and liquidating positions; (4) the submission of numerous orders that are cancelled shortly after submission; and (5) ending the trading day in as close to a flat position as possible (that is, not carrying significant, unhedged positions overnight). See Equity Market Structure Concept Release, supra note 63, 75 FR at 3606. See also Staff of the Division of Trading and Markets, "Equity Market Structure Literature Review, Part II: High Frequency Trading," at 4-5 (March 18, 2014) (available at http://www.sec.gov/marketstructure/research/hft_lit_review_march_2014.pdf).

70 The secondary market for U.S. Treasury securities (sometimes referred to as the U.S. Treasury cash market) is generally bifurcated between the dealer-to-customer market and the interdealer market. Trading in the U.S. Treasury securities dealer-to-customer market is generally conducted through bilateral transactions. Trading often occurs either over the phone or on trading venues that facilitate the matching of buy and sell orders through electronic systems. In the interdealer market, the majority of trading in on-the-run U.S. Treasury securities currently occurs on ATSs using electronic central limit order books. For off-the-run U.S. Treasury securities, the majority of interdealer trading occurs via bilateral transactions through voice-assisted brokers and electronic trading platforms. See Securities Exchange Act Release No. 90019 (September 28, 2020), 85 FR 87106, 87108 (December 21, 2020). On-the-run U.S. Treasury securities are the most recently issued U.S Treasury securities of a particular maturity. Off-the-run U.S. Treasury securities include all U.S. Treasury securities that have been issued before the most recent issuance and are still outstanding.

interdealer U.S. Treasury securities market.[71] The Joint Staff Report called for certain U.S. Treasury securities market reforms such as an assessment of the public reporting on U.S. Treasury securities market venue policies and services and a review of possible post-trade transaction reporting by government securities broker-dealers and banks. In 2016, an inter-agency working group comprising staff of the Treasury Department, Commission, Commodity Futures Trading Commission, Federal Reserve Bank of New York, and Board of Governors of the Federal Reserve System stated that it "will continue to assess effective means to ensure that the collection of data regarding Treasury cash securities market transactions is comprehensive and includes information from institutions that are that not FINRA members."[72] Subsequently, FINRA introduced TRACE reporting for U.S. Treasury securities in 2017.[73]

The Commission estimates that, as of the end of 2021, there were 66 firms that were Commission-registered broker-dealers and exchange members but not FINRA members, and that there were 65 such firms as of April 2022.[74] Many of these firms were members of just one

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71 See Joint Staff Report, supra note 67, at 36. In addition, in 2020, staff at the Board of Governors of the Federal Reserve published a paper estimating that PTFs account for 61% of the trading activity on interdealer broker platforms. See FEDS Notes, "Principal Trading Firm Activity in Treasury Cash Markets," James Collin Harkrader and Michael Puglia (Aug. 4, 2020) (citing data presented at the 2019 U.S. Treasury Market Conference showing that PTFs averaged approximately 61% of total trading volume on electronic interdealer broker platforms).

72 See press release, U.S. Dep't of the Treasury et al., Statement Regarding Progress on the Review of the U.S. Treasury Market Structure since the July 2015 Joint Staff Report (August 2, 2016) available at https://www.sec.gov/news/pressrelease/2016-155.html.

73 See supra note 44.

74 See FINRA.org, Non-Member List, available at https://nonmembers.finra.org/ReportableNonMembersList.txt or http://web.archive.org/web/20210722022409/https:/nonmembers.finra.org/ReportableNonMembersList.txt (last visited July 22, 2022). The Commission notes that the figures set forth herein are impacted by changes in FINRA membership. For example, a registered

exchange while others were members of multiple exchanges.[75] Specifically, as of April 2022, 21 of the 65 identified firms were single exchange members; 10 of the firms were members of two exchanges; 13 of the firms were members of more than two but 10 or fewer exchanges; and the remainder were members of more than 10 exchanges.[76]

Several of these firms – both single-exchange and multiple-exchange members – engage in cross-market and off-exchange proprietary securities trading. These firms account for a significant portion of off-exchange securities trading volume and initiate a significant number of securities transactions on exchanges other than exchanges to which they belong as a member.[77] They forgo FINRA membership presumably in reliance on Rule 15b9-1, as their effectuation of transactions in securities elsewhere than on exchanges to which they belong as a member would trigger Section 15(b)(8)'s Association membership requirement but for the exemption provided by Rule 15b9-1.

For example, of the estimated 66 broker-dealers that were exchange members but not FINRA members as of the end of 2021, 47 initiated orders in listed equities in September 2021 that were executed on or off an exchange.[78] These firms' September 2021 off-exchange listed

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broker-dealer that was not a FINRA member as of 2021 joined FINRA in early 2022 and is not included among the 65 firms identified as registered broker-dealers and exchange members but not FINRA members as of April 2022.

75 Source: FINRA Central Registration Depository (CRD).

76 Id.

77 Source: Consolidated Audit Trail.

78 Id. A firm "initiating" an order is the firm that reports the origination of the order as a New Order Event (MENO) to the Consolidated Audit Trail. The other 19 firms did not initiate orders in listed equities in September 2021.

equities dollar volume executed was approximately $789 billion,[79] which was approximately 9.8% of total off-exchange volume of listed equities executed that month.[80] Moreover, these firms' September 2021 listed equities dollar volume executed on exchanges of which they are not a member was approximately $592 billion.[81]

Of the estimated 65 broker-dealers that were exchange members but not FINRA members as of April 2022, 43 initiated orders in listed equities in April 2022 that were executed on or off an exchange.[82] These firms' April 2022 off-exchange listed equities dollar volume executed was approximately $441 billion,[83] which was approximately 4.6% of total off-exchange volume of listed equities executed that month.[84] Moreover, these firms' April 2022 listed equities dollar

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79 Id. Dollar volumes set forth in this section represent the sum of bought and sold volume during the specified time period.

80 Id. The Commission estimates that there was approximately $8 trillion in total off-exchange transaction volume in listed equities reported by buying and selling firms in September 2021.

81 Id. The Commission also estimates that, in 2021, 50 of the 66 firms identified as registered broker-dealers and exchange members but not FINRA members initiated options order executions accounting for approximately 15-20% of daily options contract volume traded. The Commission further estimates that 36 of these 50 firms initiated executions on an exchange where they are not a member, and that this transaction volume represented approximately 3% of these 36 firms' total options contract transaction volume reported in 2021, and approximately 1% of all options contract transaction volume reported in 2021. Id.

82 Id. The other 22 firms did not initiate orders in listed equities in April 2022.

83 Id.

84 Id. The Commission estimates that there was approximately $9.5 trillion in total off-exchange transaction volume in listed equities reported by buying and selling firms in April 2022.

volume executed on exchanges of which they are not a member was approximately $475 billion.[85]

There is also a high degree of concentration of this volume among a subset of the identified firms. In this regard, the Commission estimates that, as of September 2021, 13 of the 47 identified firms that initiated orders in listed equities then accounted for approximately 9.3% of total off-exchange listed equities volume executed in September 2021 and 94% of the off-exchange listed equities transaction volume attributable to the 47 identified firms that month.[86] Two of the 13 firms initiated $528 billion in off-exchange listed equities executions in September 2021, which was 6.6% of total off-exchange listed equities transaction volume that month and approximately two-thirds of the off-exchange volume executions attributable to the 47 identified firms.[87] With respect to the 47 firms' listed equities transaction volume on exchanges of which they are not a member, just one firm accounted for approximately 78% of the $592 billion in volume attributable to the 47 identified firms in September 2021; four firms (including the aforementioned one) accounted for approximately 90% of that volume; and 18 firms (including the aforementioned four firms) accounted for approximately 99% of that volume.[88]

The Commission also estimates that, as of April 2022, 12 of the 43 identified firms that initiated orders in listed equities then accounted for approximately 4.25% of total off-exchange

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85 Source: Consolidated Audit Trail. See also Table 1, Section VI.A.1, infra, for additional detail regarding these firms' trading activity during the noted time periods.

86 Source: Consolidated Audit Trail.

87 Id.

88 Id.

listed equities volume executed in April 2022 and 91.6% of the off-exchange listed equities transaction volume attributable to the 43 identified firms that month.[89] One of the 12 firms initiated $241 billion in off-exchange listed equities executions in April 2022, which was 2.54% of total off-exchange listed equities transaction volume that month and approximately one-half of the off-exchange volume executions attributable to the 43 identified firms.[90] With respect to the 43 firms' listed equities transaction volume on exchanges of which they are not a member, just one firm accounted for approximately 72% of the $475 billion in volume attributable to the 43 identified firms in April 2022; five firms (including the aforementioned one) accounted for approximately 91% of that volume; and 18 firms (including the aforementioned four firms) accounted for approximately 99% of that volume.[91]

With respect to trading in U.S. Treasury securities, all of which occurs off-exchange,[92] the Commission estimates that four of the 66 broker-dealers that were exchange members but not FINRA members accounted for over $7 trillion in U.S. Treasury securities volume executed on "covered ATSs" in 2021 that was reported to TRACE,[93] which was over 2% of total U.S Treasury securities volume traded in 2021 that was reported to TRACE.[94] In April 2022, the

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89 Id.

90 Id.

91 Id.

92 See Joint Staff Report, supra note 67, at 2; see also supra note 70.

93 See FINRA Rule 6730(a)(1) (requiring FINRA members to report transactions in TRACE-Eligible Securities, including U.S. Treasury securities).

94 See FINRA Rule 6730 – Transaction Reporting, Supplementary Material .07 - ATS Identification of Non-FINRA Member Counterparties for Transactions in U.S. Treasury Securities, supra note 16 (among other things, defining the term "covered ATS" as an ATS that executed transactions in U.S. Treasury securities against non-FINRA member subscribers of $10 billion or more in monthly par value, computed by aggregating buy

Commission estimates that three of the 65 broker-dealers that were exchange members but not FINRA members accounted for over $700 billion in U.S. Treasury securities volume executed on covered ATSs that was reported to TRACE,[95] which was approximately 2.5% of total U.S Treasury securities volume traded in April 2022 that was reported to TRACE.[96]

Due to the evolution of the securities markets since Rule 15b9-1 was adopted, the Commission preliminarily believes that the rule's effect has become dislodged from the rule's intended purpose. The underlying presumption built into Rule 15b9-1's de minimis allowance and proprietary trading exclusion was that Association membership should not be required where a broker-dealer engaged in limited trading activities elsewhere than its member exchange that were ancillary to its trading business on its member exchange.[97] Since the Commission adopted Rule 15b9-1 in 1965 and then the proprietary trading exclusion in 1976, the securities markets have transformed dramatically, securities trading has become dispersed among myriad trading centers, and firms today frequently trade securities proprietarily and electronically across those trading centers, including on exchanges where they are not a member and off-exchange. Moreover, today, unlike forty years ago, there is extensive off-exchange proprietary trading activity conducted electronically in the U.S. Treasury securities market, and a transaction reporting regime for U.S. Treasury securities transactions that stems from Association membership. Put simply, the underlying tenet of Rule 15b9-1's de minimis allowance and

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and sell transactions, for any two months in the preceding calendar quarter). U.S. Treasury securities market share is calculated as the sum of the identified entities' buy and sell volume divided by twice the market-wide volume for the period.

95 See supra note 93.

96 Id.

97 See supra notes 60 - 62 and accompanying text.

proprietary trading exclusion no longer holds true in light of the emergence of the modern-day broker-dealer that trades securities proprietarily.

Indeed, as reflected by the figures set forth above, some dealer firms are able to engage in substantial proprietary securities trading activity elsewhere than their member exchange(s) without becoming FINRA members, in reliance on Rule 15b9-1. These firms are not all subject to the same set of rules and interpretations, which can vary between exchanges. Importantly, FINRA has the expertise regarding off-exchange trading, but under the current regulatory structure underpinning Rule 15b9-1, for non-FINRA members that trade off-exchange and are members of different exchanges, FINRA applies the rules of the different exchanges using the exchanges' interpretations of those rules. This can result in different interpretations and FINRA registration would promote consistent interpretations and efficiencies in enforcement and regulation with respect to this growing part of the market. The rise in electronic proprietary trading and an increasingly fragmented market where trading takes place across many active markets have put pressure on the status quo and presented a need for there to be more consistent regulation of such trading. As a result, the Commission preliminarily believes that the exemption from FINRA oversight provided by Rule 15b9-1 should be limited.

In particular, there are Federal securities laws, Commission rules, and SRO rules that prohibit various forms of improper activity by broker-dealers.[98] SROs are required to examine

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98 See, e.g., Sections 10(b), 15(c), and 15(g) of the Exchange Act; 15 U.S.C. 78j(b), 15 U.S.C. 78o(c), and 15 U.S.C. 78o(g); Section 17(a) of the Securities Act of 1933; 15 U.S.C. 77q(a); 17 CFR 240.10b-5; FINRA Rules 2020 (Use of Manipulative, Deceptive, or Other Fraudulent Devices), 4530 (Reporting Requirements), 5210 (Publication of Transactions and Quotations); NYSE Rules 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices) and 5220 (Disruptive Quoting and Trading Activity Prohibited); Nasdaq General 9, Section 1 (General Standards) and Nasdaq General 9,

for and enforce compliance by their members and associated persons with the Exchange Act, the rules and regulations thereunder, and the SROs' own rules.[99] FINRA traditionally has been the SRO that primarily oversees cross-exchange and off-exchange securities trading activity. In the specific context of broker-dealer firms that are not FINRA members and effect off-member-exchange securities transactions, FINRA is unable to directly enforce such firms' compliance with Federal securities laws and Commission rules, or apply its own rules to such firms, because they are not FINRA members. Without direct, membership-based FINRA oversight, the Commission believes that SRO oversight of off-member-exchange securities trading activity by non-FINRA members is largely a function of cooperative regulatory arrangements among SROs, which, as explained below, do not confer membership-based jurisdiction to FINRA to enforce compliance with the Exchange Act and applicable rules.

In this regard, exchange SROs and FINRA are able to perform cross-market surveillance of trading activity in NMS and OTC securities using the Consolidated Audit Trail ("CAT") data.[100] But access to CAT data does not confer jurisdiction to FINRA over a firm that is not a FINRA member and that trades those securities off-exchange.[101] As a result, a case regarding

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Section 53 (Disruptive Quoting and Trading Activity Prohibited); and Cboe Rule 8.6 (Manipulation).

99 See Section 19(g) of the Act; 15 U.S.C. 78s(g).

100 Exchange rules require their members to report to CAT, which is operated by FINRA CAT, LLC, a subsidiary of FINRA. See, e.g., Cboe BYX Rules 4.5 – 4.17; Nasdaq General 7; and NYSE Rule 6800.

101 See Concept Release Concerning Self-Regulation, supra note 18, 69 FR at 71266 (stating that "[w]hile the full implementation of robust intermarket order audit trails would be a significant step forward, an order audit trail is simply a tool that can be used by regulators to better surveil for illicit trading activity" and that "the SRO regulatory function would still play a critical role in the regulation of intermarket trading."). Likewise, the ISG is a valuable forum for the coordination of regulatory efforts and sharing of information and

such a firm may be referred to the Commission or an exchange where the firm is a member for further investigation because access to CAT data alone does not enable FINRA to conduct additional investigative methods, such as collecting documents, interviewing witnesses, and otherwise investigating the firm to generate evidence.[102] Moreover, trading activity in U.S. Treasury securities is not reported to CAT, so CAT is not a tool that can be used by SROs to surveil that activity, which, as reflected by the figures set forth above, is engaged in extensively by some broker-dealers that are not FINRA members.

Exchange SROs and FINRA also have entered into 17d-2 plans[103] and RSAs. Under these arrangements, as of 2020, FINRA operated a cross-market regulatory program that covered 100% of U.S. equity market activity and approximately 45% of options contract volume, and FINRA also provided market-specific regulatory services to several exchanges.[104] The

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serves an important function, but it does not confer jurisdiction to FINRA over a broker-dealer that is not a FINRA member and effects off-member-exchange securities transactions. The ISG also does not create rules or impose disciplinary actions; rather, the information sharing between members allows for the proper authority, regulator, or exchange to pursue appropriate rule changes or pursue legal action on market participants based on evidence gathered.

102 See infra note 140.

103 There are 19 effective bilateral plans and 4 multiparty plans. The 17d-2 plans can be found on the Commission's website at: https://www.sec.gov/rules/sro/17d-2.htm.

104 See Cross-Market Regulatory Coordination Staff Paper, supra note 31 (stating that "[t]he exchanges have relied on FINRA to perform regulatory functions, including surveillance, examinations, investigations, and enforcement functions, pursuant to RSAs and Rule 17d-2 plans. Under these arrangements, FINRA has developed a cross-market program that covers 100% of U.S. equity market activity and approximately 45% of options contract volume. In addition to these cross-market supervision services, FINRA provides market-specific regulatory services to several exchanges.") (citing Letter from Marcia E. Asquith, Executive Vice President, FINRA, to Vanessa Countryman, Secretary, Commission, dated November 30, 2020).

Commission understands that these arrangements have enhanced regulatory outcomes.[105] However, neither of these arrangements creates a requirement for broker-dealers that are not FINRA members to report their U.S. Treasury securities activity to TRACE. Moreover, 17d-2 plans are valuable, Commission-approved arrangements in the context of common members of more than one SRO. A 17d-2 plan among one or more exchange SROs and FINRA would not provide FINRA with jurisdiction over a firm that is not a FINRA member, as 17d-2 plans are designed to mitigate duplicative SRO oversight over common members of more than one SRO with respect to rules that are common among the SROs. In other words, for FINRA to be named as the DEA for a firm under a 17d-2 plan, the firm would have to be a FINRA member.[106]

The Commission therefore understands FINRA's cross-market regulatory program for equities and options relies on RSAs insofar as it covers broker-dealers that are not FINRA members.[107] RSAs can be used to cover matters or firms that may fall outside the scope of a

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105 See Cross-Market Regulatory Coordination Staff Paper, supra note 31.

106 For example, under a 17d-2 plan among exchange SROs and FINRA, FINRA is the Designated CAT Surveillance Authority (DCSA) for members of the exchange SROs and FINRA, and in that capacity assumes surveillance, investigation and enforcement responsibility relating to compliance by common members with Rule 613 and the rules of the SROs regarding compliance with the CAT NMS Plan. See Securities Exchange Act Release No. 89042 (June 10, 2020), 85 FR 36450 (June 16, 2020) (File No. 4-618). But FINRA is not the DCSA for firms that are not FINRA members.

107 See, e.g., Securities Exchange Act Release No. 89972 (September 23, 2020), 85 FR 61062, 61063 (September 29, 2020) (amending the 17d-2 plan among exchange SROs and FINRA relating to the surveillance, investigation, and enforcement of insider trading rules, which allocates regulatory responsibility to FINRA over common FINRA members (members of FINRA and at least one of the exchange SRO participants in the plan), and stating that the participating exchange SROs will also enter into an RSA to provide for the investigation and enforcement of suspected insider trading against broker-dealers that are not common FINRA members).

17d-2 plan.[108] While RSAs can serve useful purposes, they generally are not publicly available, are not subject to Commission approval, and are voluntary private agreements between SROs that are not mandated by any Commission rule or statutory obligation and that may expire or be terminated by the parties.[109] As a result, to the extent FINRA oversight is applied to non-FINRA member firms' off-member-exchange securities trading activity based on RSAs, such oversight relies upon arrangements between exchanges and FINRA that are discretionary. In addition, under an RSA, FINRA examines for compliance with the rules of the exchange that has entered into the RSA. Thus, non-FINRA members that are members of different exchanges may be subject to different exchange rules and interpretations when they effect off-member-exchange securities transactions to the extent these rules and interpretations are different. This approach is less stable and consistent than a regulatory regime in which Association membership and oversight is mandated.

Further, the continued availability of the Rule 15b9-1 exemption from Association membership detracts from FINRA's off-exchange securities transaction reporting regime, and in particular, TRACE reporting for U.S. Treasury securities transactions. The "covered ATS" U.S. Treasury security volumes set forth above may not capture all of those firms' U.S. Treasury

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108 See Cross-Market Regulatory Coordination Staff Paper, supra note 31.

109 Unlike with Commission-approved 17d-2 plans, the SRO paying for regulatory services under an RSA retains ultimate legal responsibility for and control over the functions allocated to the service-providing SRO under the RSA. Further, in the context of an RSA in which an exchange SRO contracts with FINRA for FINRA to provide regulatory services on behalf of the exchange SRO, FINRA's oversight of the off-member-exchange trading activity of a non-FINRA member firm that is a member of the exchange is for compliance with the exchange's rules, not FINRA's rules.

securities transaction volume.[110] Broker-dealers that are not FINRA members are not required to report their U.S. Treasury securities transactions to FINRA's TRACE system because TRACE reporting obligations for U.S. Treasury securities transactions apply only to broker-dealers that are FINRA members.[111] When a non-FINRA member broker-dealer trades U.S. Treasury securities through a covered ATS, the covered ATS is obligated in its TRACE report to identify the non-FINRA member via its MPID,[112] thus providing visibility to regulators as to what transactions on covered ATSs are attributable to non-FINRA members. But regulators have no such visibility when non-FINRA member broker-dealers trade U.S. Treasury securities on an ATS that is not a covered ATS or otherwise than on an ATS with a counterparty that also is not a FINRA member. In the former case, the transaction still must be reported to TRACE but the non-FINRA member is not specifically identified via a MPID and instead is identified only as a "customer"; in the latter case, there is no TRACE reporting obligation whatsoever.[113] These

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110 In the proposal the Commission issued in January 2022 to, among other things, amend Regulation ATS for ATSs that trade U.S. government securities, the Commission estimated that there would be 7 trading systems that trade only government securities or repurchase or reverse repurchase agreements on government securities and operate pursuant to the Exchange Act Rule 3a1-1(a)(3) exemption and which would be required to comply with Regulation ATS under the proposal. See Securities Exchange Act Release No. 94062 (January 26, 2022), 87 FR 15496, 15523 (March 18, 2022).

111 See FINRA Rule 6720 – Participation in TRACE. Beginning September 1, 2022, certain depository institutions will be required to report to TRACE transactions in U.S. Treasury securities, agency debt securities and agency mortgage-backed securities. See FINRA.org, Federal Reserve Depository Institution Reporting to TRACE, available at https://www.finra.org/filing-reporting/trace/federal-reserve-depository-institution-reporting (last visited July 22, 2022).

112 See FINRA Rule 6730 – Transaction Reporting, Supplementary Material .07 - ATS Identification of Non-FINRA Member Counterparties for Transactions in U.S. Treasury Securities, supra note 16.

113 In addition, in the context of an NMS stock transaction effected between a FINRA member and a non-FINRA member otherwise than on an exchange, only the FINRA

circumstances detract from the comprehensiveness of U.S. Treasury securities TRACE data and regulators' ability to utilize that data to detect and deter improper trading activity in the U.S. Treasury securities market. The Commission cannot quantify total secondary market trading in U.S. Treasury securities due to the current lack of comprehensive data in U.S. Treasury securities in TRACE. Moreover, broker-dealers that are not FINRA members have a potential competitive advantage over those that are FINRA members and thus incur the costs of reporting transactions in U.S. Treasury securities transactions.

Accordingly, the Commission is proposing to update Rule 15b9-1 such that proprietary trading firms that are registered broker-dealers generally must join FINRA, pursuant to Section 15(b)(8) of the Act, if they effect securities transactions otherwise than on an exchange of which they are a member. The Commission preliminarily believes that amending Rule 15b9-1 so that broker-dealer proprietary trading firms generally would be required to join FINRA if they trade elsewhere than on an exchange where they are a member would address the above-described issues by subjecting such firms to FINRA's direct, membership-based jurisdiction and rules, including FINRA's TRACE reporting regime for U.S. Treasury security transactions. This would be consistent with the Exchange Act's statutory framework for complementary exchange SRO and Association oversight of broker-dealer trading activity, in which Section 15(b)(8) requires broker-dealers to join an Association if they effect securities transactions elsewhere than

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member is obligated to report the transaction to the FINRA TRF and the non-FINRA member generally is not identified on the trade report as the contra party to the trade. See Trade Reporting Frequently Asked Questions, Reporting Relationships and Responsibilities, Section 202: Reporting Trades with a Non-FINRA Member, available at: https://www.finra.org/filing-reporting/market-transparency-reporting/trade-reporting-faq#202 (last visited July 22, 2022). The non-FINRA member is, however, identified in CAT in this context.

an exchange where they are a member. Amending Rule 15b9-1 in this way also would modernize the rule in a manner that is consistent with how proprietary trading occurs today and that promotes Section 15(b)(9)'s requirement that any exemption from Section 15(b)(8) be consistent with the public interest and protection of investors. The Commission believes that direct, membership-based FINRA oversight over and the application of FINRA's securities transaction reporting requirements to firms that effect off-member-exchange securities transactions would create more effective SRO oversight over their off-member-exchange securities trading activity and therefore promote the protection of investors and the public interest.

As discussed above,[114] the Exchange Act requires dual SRO and Commission oversight of registered broker-dealers, with SROs acting as robust, front-line regulators of their broker-dealer members. The Commission may bring enforcement actions, including pursuant to referrals made by SROs, to enforce broker-dealers' compliance with the Exchange Act and applicable rules, and SROs have regulatory authority over their members pursuant to the Exchange Act. Moreover, Section 15(b)(8)'s complementary SRO oversight structure generally has enabled exchange SROs to specialize in oversight of securities trading activity that occurs on the exchange, and FINRA to specialize in oversight of cross-market, off-member-exchange securities trading activity. The Commission believes that rescinding Rule 15b9-1's de minimis allowance and proprietary trading exclusion would better enable robust and consistent FINRA oversight in the area of its expertise through direct, membership-based jurisdiction of broker-dealers that effect off-member-exchange securities transactions proprietarily. This, in turn, could

114 See Section II.A, supra.

strengthen the front-line layer of SRO regulatory oversight that is applied to off-member-exchange proprietary securities trading in today's market.

Requests for Comment:

The Commission requests comment on all aspects of the foregoing background discussion as well as, in particular, on the following questions:

1. Is the Commission's estimate of the number of broker-dealers that are exchange members but not FINRA members still accurate as of the time of publication of this re-proposal? Is it too high or too low? Are there broker-dealers that were not FINRA members as of April 2022 that have since joined FINRA? Please explain.
2. Are the Commission's estimates of the securities transaction volumes attributable to non-FINRA member broker-dealers accurate? If not, why are they inaccurate? Are there any uncertainties associated with such estimates?
3. Do exchange SROs directly exercise their SRO authority with respect to off-member-exchange securities trading activity by their members? If so, how have exchange SROs exercised their authority in this regard? In particular, how, if at all, have exchange SROs sought to exercise SRO authority over off-member-exchange securities trading activity conducted by their broker-dealer members that are not FINRA members? Have exchange SROs sought to exercise authority over U.S. Treasury securities trading activity by their members? Please explain and provide examples, if possible.
4. Do RSAs or other cooperative arrangements among SROs cover the U.S. Treasury securities trading activity conducted by broker-dealers that are

exchange members but not FINRA members? If so, please specify the arrangements and how they work, including any limitations associated with such arrangements.

5. Is the Commission's understanding correct that FINRA's cross-market regulatory program for equities and options is based on RSAs insofar as it covers broker-dealers that are not FINRA members? If not, how are broker-dealers that are not FINRA members covered?

C. 2015 Proposal

The Commission previously proposed to amend Rule 15b9-1 in March 2015.[115] The 2015 Proposal would have eliminated the de minimis allowance and proprietary trading exclusion from the rule, and added language to the rule that more closely tracked Section 15(b)(8) in providing an exemption from Section 15(b)(8)'s Association membership requirement only for a broker or dealer that carries no customer accounts and effects transactions in securities solely on a national securities exchange of which it is a member except in certain limited circumstances.[116] The Commission did not adopt the 2015 Proposal but, as discussed

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115 See 2015 Proposing Release, supra note 6, 80 FR 18036-37.

116 The 2015 Proposal would have provided exemptions from Association membership for a dealer that is an exchange member, carries no customer accounts, and effects transactions elsewhere than an exchange of which it is a member solely for the purpose of hedging the risks of its floor-based activity; or for a broker or dealer that is an exchange member, carries no customer accounts, and effects transactions elsewhere than an exchange of which it is a member that result from orders that are routed by a national securities exchange of which it is a member to prevent trade-throughs, consistent with the provisions of Rule 611 of Regulation NMS. As discussed below, the Commission is re-proposing herein that amended Rule 15b9-1 set forth a modified version of that routing exemption but is not including in this re-proposal a hedging exemption outside the context of stock-option orders.

above, remains concerned that proprietary trading dealer firms' reliance on the Rule 15b9-1 exemption from Association membership undermines the effectiveness of the SRO regulatory structure and SRO oversight of the securities markets as envisioned by Congress in the Exchange Act. Therefore, today the Commission is re-proposing amendments to Rule 15b9-1 that are similar to what was proposed in 2015, but modified in certain respects in light of the Commission's further consideration of what set of circumstances would continue to be appropriate for an exemption from Association membership in today's market, which consideration is informed by comments on the 2015 Proposal.[117]

III. Discussion of Amendments to Rule 15b9-1

As a general matter, the result under the amended version of Rule 15b9-1 being proposed today would be the same as under the 2015 Proposal: a broker or dealer would be required to join an Association if it effects transactions in securities elsewhere than on an exchange to which it belongs as a member, unless it can rely upon one of the amended rule's narrow exceptions.[118] Conversely, a broker or dealer would not need to become a member of an Association if it effects securities transactions only on an exchange of which it is a member.[119] The Commission preliminarily believes that these outcomes would enhance SRO regulatory oversight in a manner

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117 See supra note 17.

118 See proposed Rule 15b9-1; see also 2015 Proposing Release, supra note 6.

119 See Section 15(b)(8) of the Act. If a broker or dealer is a member of multiple exchanges and effects securities transactions only on those exchanges, those exchanges could enter into an RSA to ensure effective cross-market supervision of this activity. The Commission acknowledges that in the future another SRO could assume these responsibilities pursuant to 17d-2 plans, subject to Commission approval. In addition, a given exchange may choose to enter into an RSA with an Association, as some exchanges have now. In those cases, the exchange maintains the ultimate responsibility for the contracted regulatory responsibilities.

that promotes Section 15(b)(8) of the Act and the public interest and investor protection requirements of Section 15(b)(9) of the Act by enabling direct Association oversight of off-member-exchange broker-dealer proprietary trading activity. Several commenters supported the 2015 Proposal.[120] Some commenters questioned the necessity of expanded FINRA oversight.[121]

As noted above, Rule 15b9-1 currently exempts any broker or dealer from membership in an Association if it is a member of a national securities exchange, carries no customer accounts, and has annual gross income of no more than $1,000 that is derived from purchases or sales of securities effected otherwise than on an exchange of which it is a member.[122] Under the rule's proprietary trading exclusion, income derived from transactions for a dealer's own account with or through another registered broker or dealer is excluded from the de minimis allowance.[123]

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120 See, e.g., Letters from: Ryan W. Porter, Founder, High Amplitude Capital Trading (March 28, 2015) ("Porter Letter") at 1; Chris Barnard (May 20, 2015) ("Barnard Letter") at 1 (stating that the proposal would "improve the consistency and effectiveness of regulatory supervision; reduce the existing differential regulatory burden of Member Firms and Non-Member Firms; and promote firms to compete more equitably to supply liquidity both on exchanges and off-exchange."); Claudia Crowley, Chief Regulatory Officer, IEX Group, Inc. (May 22, 2015) ("IEX Letter") at 2 (stating that there is a need to update the exemption in Rule 15b9-1 to better align it with its original intent and "better reflect current market technology and practices" which would result in "more comprehensive and consistent regulatory oversight of off-exchange market activity."); Marcia E. Asquith, Senior Vice President and Corporate Secretary, FINRA (June 2, 2015) ("FINRA Letter") at 9-10; Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA (June 1, 2015) ("SIFMA Letter") at 1; Angelo Evangelou, Associate General Counsel, Legal Division, Cboe (June 10, 2015) ("Cboe Letter") at 1 (supporting the proposal "insofar as the rulemaking seeks to require FINRA membership of proprietary firms whose primary business is executing transactions off-exchange."); and Elliot Grossman, Managing Director, Dinosaur Securities (Sep. 15, 2015) ("Dinosaur Letter") at 2.

121 See infra notes 125 - 127 and accompanying text.

122 17 CFR 240.15b9-1(a).

123 17 CFR 240.15b9-1(b)(1). The current rule also states that the de minimis allowance does not apply to income derived from transactions through the Intermarket Trading

The Commission is proposing to eliminate the de minimis allowance and the proprietary trading exclusion, and continue to allow an exemption from Association membership only for a registered broker or dealer that is an exchange member, carries no customer accounts, and effects securities transactions solely on a national securities exchange of which it is a member except in two narrow circumstances: (1) a broker or dealer effects transactions in securities otherwise than on an exchange to which it belongs as a member that result solely from orders that are routed by an exchange of which it is a member in order to comply with Rule 611 of Regulation NMS or the Options Order Protection and Locked/Crossed Market Plan; or (2) a broker or dealer effects transactions in securities otherwise than on an exchange to which it belongs as a member that are solely for the purpose of executing the stock leg of a stock-option order. In the subsections below, the Commission discusses each element of the re-proposed rule in detail.

A. Elimination of the De Minimis Allowance and Proprietary Trading Exclusion

As in the 2015 Proposal, today the Commission is re-proposing to delete paragraphs (a)(3) and (b) from Rule 15b9-1.[124] This would eliminate the de minimis allowance and proprietary trading exclusion. As a result, under Rule 15b9-1 as amended, any broker or dealer required by Section 15(b)(8) of the Act to become a member of an Association would be exempt from that requirement only if it is a member of a national securities exchange, carries no

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System ("ITS"), and defines the term "Intermarket Trading System" for purposes of the rule. 17 CFR 240.15b9-1(b)(2) and (c). ITS was a national market system plan ("NMS Plan") that was eliminated in 2007 because it was superseded by Regulation NMS. See infra notes 159 - 168 and accompanying text. Since Rule 15b9-1's references to ITS are now obsolete, as in the 2015 Proposal, the Commission is re-proposing to eliminate these references from the rule.

[124] The Commission also is proposing to renumber the paragraphs that remain in the amended rule.

customer accounts, and any securities transactions that it effects elsewhere than on an exchange of which it is a member meet the limited criteria set forth in proposed paragraph (c) of the amended rule, which are discussed in detail below. The re-proposed elimination of the de minimis allowance and proprietary trading exclusion would generally preclude proprietary trading firms that are registered with the Commission pursuant to Section 15 of the Act and conduct off-member-exchange securities trading from relying on Rule 15b9-1 as an exemption from Section 15(b)(8)'s Association membership requirement. Therefore, pursuant to Section 15(b)(8), they would be required to become a member of an Association unless they effect transactions in securities solely on an exchange of which they are a member.

Some commenters on the 2015 Proposal questioned the necessity and appropriateness of the expanded FINRA oversight that would result from the then-proposed elimination of the de minimis allowance and proprietary trading exclusion. Their concerns centered on assertions that exchange oversight may be more effective than FINRA oversight,[125] FINRA membership would

125 See, e.g., Letters from: Mary Ann Burns, Chief Operating Officer, FIA Principal Traders Group (June 1, 2015) ("FIA 2 Letter") at 4; Joanne Moffic-Silver, Executive Vice President, General Counsel and Corporate Secretary, Cboe, Elizabeth K. King, Secretary and General Counsel, NYSE, Joan C. Conley, Senior Vice President and Corporate Secretary, NASDAQ OMX Group, Inc., (June 1, 2015) ("Cboe/NYSE/Nasdaq Letter") at 2; James Ongena, Senior Vice President and General Counsel, Chicago Stock Exchange (June 1, 2015) ("CHX Letter") at 2; Jay Coppoletta, Chief Legal Officer, PEAK6 Capital Management LLC (June 1, 2015) ("PEAK6 Letter") at 2; Frank A. Bednarz, Global Co-Head of Trading, CTC Trading Group, LLC (June 1, 2015) ("CTC Letter") at 2-3.

result in duplicative regulation for certain firms,[126] and FINRA regulation is customer-focused and therefore not appropriate for proprietary trading firms that do not carry customer accounts.[127]

The Commission continues to believe, however, that in today's market the de minimis allowance and proprietary trading exclusion are no longer appropriate, and that direct Association regulation generally of broker-dealers' off-member-exchange securities trading activity, consistent with what Congress envisioned in Section 15(b)(8) of the Act, would promote the protection of investors and the public interest pursuant to Section 15(b)(9) of the Act. As discussed above, the de minimis allowance and proprietary trading exclusion originally were intended to permit a type of off-exchange activity that no longer occurs today.[128] When the Commission adopted Rule 15b9-1 and then the proprietary trading exclusion, virtually all trading activity was conducted manually on the floors of national securities exchanges.[129] Today's market structure is dramatically different – proprietary, cross-market order routing and trading strategies are a significant component of the markets, and exchange floor-based businesses represent only a fraction of market activity. Despite this transformative shift in how trading is

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126 See, e.g., Letters from: Mark E. Gannon, Chief Compliance Officer, Lakeshore Securities, LP (June 4, 2015) ("Lakeshore Letter") at 2-3; Mark Schepps, General Counsel and Senior Director of Compliance, D&D Securities, Inc. (May 29, 2015) ("D&D Letter") at 3.

127 See, e.g., CTC Letter at 2-3; PEAK6 Letter at 2; Letter from Gregory F. Hold, CEO, Hold Brothers Capital LLC (June 1, 2015) ("Hold Brothers Capital Letter") at 2.

128 See supra note 60 and accompanying text. The Commission is unaware of any floor members today that refer accounts to other broker-dealers in exchange for a share of commission revenues.

129 See, e.g., Special Study, supra note 62, at 98 ("Trading by NYSE members on the Exchange but from off the floor accounts for approximately 5 percent of total Exchange purchases and sales . . .").

conducted, the de minimis allowance and proprietary trading exclusion set forth in Rule 15b9-1 have never been adjusted.

Rule 15b9-1's stasis notwithstanding the market's transformation has led to a misalignment in the complementary regulatory structure contemplated by Congress since FINRA does not have direct, membership-based jurisdiction over off-member-exchange securities trading activity by broker-dealers that are not FINRA members. The Exchange Act established the concept of an Association as the regulator of such trading activity,[130] a role currently fulfilled by FINRA, which also is the SRO to which off-exchange trades are reported.[131] As noted above, as of April 2022 there were approximately 65 brokers or dealers that were not FINRA members, including active proprietary trading firms, which accounted for a significant percentage of off-exchange equities and U.S. Treasury securities transaction volumes, as well as a significant amount of transaction volume on exchanges where they are not a member.[132] The Commission is concerned that the current cross-market regulatory program applied to such firms' off-member-exchange securities trading activity – which the Commission understands is dependent on RSAs – is not as stable or consistent as direct, membership-based Association oversight through FINRA membership in addressing any such trading activity and does not trigger FINRA's off-exchange transaction reporting obligations for such firms. Under the amended rule, the 65 firms identified above generally would not be exempt from Section 15(b)(8) of the Act and therefore would be required to join FINRA (unless they qualify for one of the amended rule's exceptions), the only Association currently, to the extent that they effect securities

130 See 15 U.S.C. 78o(b)(8).

131 See supra notes 40 - 43 and accompanying text.

132 See supra notes 79 - 94 and accompanying text.

transactions elsewhere than an exchange where they are a member. The Commission believes that direct, membership-based FINRA oversight over and the application of FINRA's securities transaction reporting requirements to such firms would create more effective SRO oversight over their off-member-exchange securities trading activity and therefore promote the protection of investors and the public interest.

Contrary to certain commenters' suggestion that FINRA oversight of proprietary trading firms is not necessary since they do not carry customer accounts, FINRA has established a regulatory regime for broker-dealers that effect off-member-exchange securities transactions that applies to FINRA members regardless of whether they handle customer orders or carry customer accounts. For example, FINRA has developed a detailed set of rules in core areas such as trading practices,[133] business conduct,[134] financial condition and operations,[135] and

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133 See FINRA Rule 5000 Series – Securities Offerings and Trading Standards and Practices. For instance, FINRA prohibits members from coordinating prices and intimidating other members. See FINRA Rule 5240(a), providing, among other things, that "[n]o member or person associated with a member shall: (1) coordinate the prices (including quotations), trades or trade reports of such member with any other member or person associated with a member, or any other person; (2) direct or request another member to alter a price (including a quotation); or (3) engage, directly or indirectly, in any conduct that threatens, harasses, coerces, intimidates or otherwise attempts improperly to influence another member, a person associated with a member, or any other person."

134 See FINRA Rule 2000 Series – Duties and Conflicts, supra note 38.

135 See FINRA Rule 4000 Series – Financial and Operational Rules. For example, FINRA Rule 4370(a) provides, among other things, that "[e]ach member must create and maintain a written business continuity plan identifying procedures relating to an emergency or significant business disruption. Such procedures must be reasonably designed to enable the member to meet its existing obligations to customers. In addition, such procedures must address the member's existing relationships with other broker-dealers and counter-parties. The business continuity plan must be made available promptly upon request to FINRA staff."

supervision,[136] many of which apply to FINRA members regardless of whether they handle customer orders or carry customer accounts.[137] FINRA's ability to create a consistent regulatory framework for all such broker-dealers that effect securities transactions elsewhere than on exchanges where they are a member, including the off-exchange market, is undermined by the subset of such broker-dealers that are not FINRA members in reliance on Rule 15b9-1. Moreover, part of FINRA's regulatory framework is its transaction reporting regime, and it is not customer-focused – it applies to FINRA members regardless of whether they handle customer orders or carry customer accounts.[138] Continuing to permit an exemption from FINRA membership on the basis that dealers that, for example, trade U.S. Treasury securities proprietarily do not have customers would not help improve the comprehensiveness of U.S. Treasury securities transaction reporting to TRACE or address the potential competitive advantage of non-FINRA members that, unlike FINRA members, may trade U.S. Treasury securities without reporting those transactions.

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136 See FINRA Rule 3000 Series – Supervision and Responsibilities Relating to Associated Persons. This rule series generally requires FINRA member firms, among other things, to establish, maintain, and enforce written procedures to supervise the types of business in which the firm engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. See e.g., FINRA Rules 3110 (Supervision), 3120 (Supervisory Control System), and 3170 (Tape Recording of Registered Persons by Certain Firms). See also FINRA By-Laws Article III – Qualifications of Members and Associated Persons. Any person associated with a member firm who is engaged in the securities business of the firm – including partners, officers, directors, branch managers, department supervisors, and salespersons – must register with FINRA.

137 See, e.g., the FINRA rules set forth in notes 38 - 43 and 133 - 136 supra and accompanying text.

138 See FINRA Rule 6000 Series (Quotation, Order, and Transaction Reporting Facilities), supra note 40.

In addition, an Association's regulatory responsibility, like exchange SROs', includes an obligation to monitor for operational and regulatory issues, as well as issues relating to market disruptions.[139] The inability of FINRA to directly enforce regulatory compliance by non-FINRA member proprietary trading firms – whether or not they handle customer orders or carry customer accounts – may create a risk to the fair and orderly operation of the market because, for example, if FINRA were to detect that a non-FINRA member is effecting off-member-exchange securities transactions that are not in compliance with the Exchange Act or applicable rules, FINRA would not have direct, membership-based jurisdiction to directly address the behavior.[140] This is the case regardless of whether the firm has customers. And as discussed above,[141] the Commission believes that RSA-based regulatory efforts among exchange SROs and FINRA, while beneficial in many contexts, are a less stable and consistent mechanism for SRO oversight than the Association membership required by the Exchange Act in the context presented here.

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139 15 U.S.C. 78o-3.

140 FINRA could refer such a matter to the Commission. See, e.g., Statement of Robert W. Cook, President and CEO, FINRA, "Equity Market Surveillance Today and the Path Ahead" (Sep. 20, 2017), available at https://www.finra.org/media-center/speeches-testimony/equity-market-surveillance-today-and-path-ahead (stating that FINRA makes referrals to the Commission or other authorities if the target of an investigation is beyond the collective jurisdiction of FINRA and the exchanges, and that in a prior year FINRA's market regulation department made over 500 referrals to the Commission on behalf of FINRA and its exchange clients related to potential abusive trading strategies or other rule violations). FINRA also could refer such a matter to an exchange where the firm is a member or, as discussed above, potentially address the matter through an RSA if covered by the terms of the RSA.

141 See supra Section II.B. As is also discussed above, while the Commission can bring enforcement actions, including pursuant to SRO referrals, that Commission layer of regulatory oversight is meant to work in tandem with, not in place of, a robust front-line layer of SRO oversight. See supra Sections II.A and II.B.

Moreover, contrary to commenters' assertions, the Commission does not preliminarily believe that exchange oversight alone would be more effective at remedying the above-described issues than direct FINRA oversight of off-member-exchange securities trading activity through the Association membership envisioned by Congress, or that FINRA membership would result in duplicative regulation for broker-dealer proprietary trading firms. The imposition of FINRA rules on such firms would require them to report their U.S. Treasury securities transactions under FINRA's TRACE reporting regime. It also would require that such firms be identified in off-exchange NMS stock transaction reports to FINRA's TRFs,[142] and thus promote broader public market transparency in NMS stocks.[143] Firms that are not FINRA members generally are not identified in TRF transaction reports.[144] Moreover, FINRA registration would confer jurisdiction to FINRA to regulate directly off-member-exchange trading activity as Congress envisioned in Section 15(b)(8) of the Act, to apply a more consistent regulatory framework to such trading activity, and to mitigate the risks to the fair and orderly operation of the market that stem from FINRA's current lack of direct oversight of non-FINRA members. Further, due to FINRA's experience and expertise in cross-market supervision, the Commission preliminarily believes that FINRA is well-positioned to assume direct jurisdiction over dealer firms that currently are not FINRA members and effect securities transactions elsewhere than exchanges

142 See supra note 42 and accompanying text.

143 See FINRA Rule 6000 Series – Quotation, Order, and Transaction Reporting Facilities and FINRA Rule 7000 Series – Clearing, Transaction and Order Data Requirements, and Facility Charges, supra note 40; see also note 112 and accompanying text.

144 See supra note 113.

where they are a member.[145] As for the potential for duplicative SRO oversight, to the extent such firms also effect securities transactions on exchanges where they are a member, 17d-2 plans are designed to mitigate duplicative SRO oversight over common members.

Some commenters on the 2015 Proposal also contended that the availability of CAT data would mitigate the need to subject proprietary trading firms to FINRA SRO oversight.[146] As

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145 One commenter stated that the costs of cross-market surveillance "are appropriately funded by exchanges as regulators of their markets and FINRA as the regulator of the off-exchange market." See Letter from Adam Nunes, Head of Business Development, Hudson River Trading LLC (June 1, 2015) ("HRT Letter") at 9. This commenter further stated that the Commission should not "attempt to address cross-market surveillance by forcing all broker-dealers to become members of FINRA" and should attempt to "ensure that cross-market surveillance is not dependent on exchanges outsourcing exchange regulation to FINRA, as it leads to the possibility that changes to RSAs and 17d-2 agreements could substantially degrade the ability to perform appropriate cross-market surveillance." Id. This commenter also weighed the appropriateness of subjecting all broker-dealers to FINRA oversight and the benefits of regulatory standardization against potential negatives associated with having a single regulator. Id. at 9-11. See also CHX Letter at 1-2 (stating concern about a single point of failure in regulatory surveillance and oversight practices). As discussed above, in the specific context of broker-dealers that are not FINRA members and that effect off-member-exchange securities transactions, the Commission believes that cross-market surveillance is not performed via 17d-2 plans and should not be dependent on RSAs. See supra Sections II.A and II.B (discussing, among other things, that Commission approval of a 17d-2 plan relieves an SRO of the regulatory responsibilities allocated by the plan to another SRO but only with respect to common members of the participating SROs, and that RSAs' coverage is not limited to common members of the participating SROs but RSAs are discretionary arrangements among SROs that do not relieve the SRO contracting for regulatory services of ultimate regulatory responsibility over its members). Moreover, consistent with Section 15(b)(8) of the Act, broker-dealers that do not effect securities transactions otherwise than on an exchange where they are a member would not be required to join FINRA. In addition, as re-proposed and discussed below, Rule 15b9-1 would continue to provide certain narrow exemptions from Section 15(b)(8)'s Association membership requirement for broker-dealers that do effect securities transactions otherwise than on an exchange where they are a member. Thus, the Commission does not believe it is necessarily the case that all broker-dealers would be required to join FINRA as a result of the proposal.

146 See, e.g., CHX Letter at 2.

discussed above, the Commission preliminarily believes that the NMS and OTC securities data available to SROs through the CAT NMS Plan are helpful tools, but such access does not confer jurisdiction to FINRA over a firm that is not a FINRA member and that trades those securities off-exchange, or ensure that an individual exchange SRO of which such a firm is a member would seek to enforce compliance with its rules, Commission rules or Federal securities laws with respect to the firm's off-member-exchange activity.[147] Even if one or more exchanges of which a broker-dealer is a member and FINRA could coordinate SRO oversight of the non-FINRA member firm's off-member-exchange securities trading activity through the use of CAT data and RSAs, performing SRO oversight in this manner is less certain and stable than direct Association oversight of such trading activity due to the discretionary nature of RSAs, and frustrates the regulatory scheme established by Congress in which an Association directly regulates broker-dealers that effect securities transactions elsewhere than exchanges where they are a member.[148] Further, CAT reporting obligations do not apply to U.S. Treasury securities, U.S. Treasury securities are not traded on any exchange, and to the Commission's knowledge, unlike FINRA,[149] no exchange SRO possesses the expertise or proclivity to exert SRO oversight

147 See supra Section II.B.

148 See 2015 Proposing Release, supra note 6, 80 FR 18039 at notes 28 - 33 and accompanying text describing the regulatory history of off-exchange trading. See also Cross-Market Regulatory Coordination Staff Paper, supra note 31 (stating that "[w]hile multiple SROs reviewing the same securities activities can have benefits, in that the resources and expertise from several organizations can be brought to bear on assessing these activities, it also can lead to duplication and inefficiencies in the regulatory process and increased burdens on member firms."). FINRA and the exchange SROs have a history of coordinating and can work together to address concerns of firms that are receiving duplicative regulatory requests such as through the Cross Market Regulatory Working Group. Id.

149 See supra notes 32 - 33 and accompanying text.

over their members' U.S. Treasury securities trading activity. Access to CAT data would not shed light on firms' U.S. Treasury securities trading activity or provide exchanges or FINRA with any ability to monitor that activity.

As is discussed in more detail in the Economic Analysis, firms that must become FINRA members would become subject to the fees charged by FINRA to all of its member firms. FINRA charges each member firm certain regulatory fees designed to recover the costs to FINRA of the supervision and regulation of members, including performing examinations, financial monitoring, and policy, rulemaking, interpretive, and enforcement activities.[150] These regulatory fees include a Trading Activity Fee ("TAF"),[151] which, at the time of the 2015 Proposal, was a primary source of commenter concern over the costs of FINRA membership that would be borne by proprietary trading firms.[152]

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150 FINRA Schedule A to the By-Laws of the Corporation ("FINRA Schedule A"), at Section 1.

151 FINRA uses the TAF to recover the costs to FINRA of the supervision and regulation of members, including performing examinations, financial monitoring, and policy, rulemaking, interpretive, and enforcement activities. See FINRA Schedule A, Section 1(a), available at https://www.finra.org/rules-guidance/rulebooks/corporate-organization/section-1-member-regulatory-fees. The TAF is generally assessed on FINRA member firms for all equity sales transactions that are not performed in the capacity of a registered exchange specialist or market maker. See id. at Section 1(b). Many of the broker-dealers that could be required to join FINRA if the proposed amendments to Rule 15b9-1 are adopted effect securities transactions in large volumes throughout the national market system, and often in a capacity other than as a registered market-maker. See also infra note 241 and accompanying text for further discussion of the TAF.

152 See, e.g., Letter from Mary Ann Burns, Chief Operating Officer, FIA (May 6, 2015) ("FIA 1 Letter") at 1, PEAK6 Letter at 2, Hold Brothers Capital Letter at 2, Lakeshore Letter at 2, CTC Letter at 5-6, D&D Letter at 2, Mark Schepps, General Counsel and Senior Director of Compliance, PTR, Inc. (May 29, 2015) ("PTR Letter") at 2, Letter from Eric Chern, CEO, CTC Trading Group, L.L.C., Andrew Killion, CEO, Akuna Capital LLC, Thomas Hutchinson, President, Belvedere Trading LLC, Steven J. Gaston,

Shortly after the Commission published the 2015 Proposal, FINRA issued a Regulatory Notice proposing to amend the TAF such that it would not apply to transactions by a proprietary trading firm effected on exchanges of which the firm is a member.[153] FINRA stated in its Regulatory Notice that it would implement the TAF amendments to coincide with the compliance date of amendments to Rule 15b9-1. Given FINRA's prior consideration of amendments to its TAF, FINRA may again evaluate its TAF to ensure that it appropriately reflects the activities of, and regulatory responsibilities towards, broker-dealer proprietary

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Chief Compliance Officer, Consolidated Trading LLC, Trent Cutler, CEO, Cutler Group LP, John Kinahan, CEO, Group One Trading, L.P., Marc Liu, CEO, Integral Derivatives LLC, Craig S. Donohue, Executive Chairman, The Options Clearing Corporation, Sebastiaan Koeling, CEO, Optiver US, LLC, Andrew Tourney, Chief Compliance Officer, Peak6 Investments, L.P., Brian Donnelly, CEO, Volant Trading (July 13, 2016) ("Options Market Makers Letter") at 6, and FIA 2 Letter at 5.

153 See FINRA Regulatory Notice 15-13, Trading Activity Fee (May 2015), available at http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-13.pdf. FINRA, in its Regulatory Notice, stated that it analyzed the potential application and impact of the TAF to proprietary trading firms and believed it could result in a significant TAF obligation for these firms that may be disproportionate to FINRA's anticipated costs associated with the financial monitoring and trading surveillance of these firms, in large part because these firms do not have customers. Id. By way of example, FINRA stated that it conducts reviews for best execution (FINRA Rule 5310), trading ahead of customer orders (FINRA Rule 5320), and display of customer limit orders (Exchange Act Rule 604), all of which are directed at firms that have customers or receive orders from customers of another broker-dealer. Id. To the extent that firms that join FINRA do not carry customer accounts, FINRA would not have to surveil such firms for compliance with these rules. The objective of the contemplated TAF amendment, according to FINRA, would be to tailor the TAF to FINRA's anticipated costs associated with the financial monitoring and trading surveillance of those firms that would be required to become FINRA members as a result of the Commission's proposed amendments.

trading firms that would be required to join FINRA if the proposed amendments to Rule 15b9-1 are adopted.[154]

On March 28, 2022, the Commission proposed changes to the definition of "dealer" and "government securities dealer," within the meaning of Sections 3(a)(5) and 3(a)(44) of the

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154 Commenters on the 2015 Proposal addressed the costs of FINRA membership, with some suggesting that the costs would be burdensome for proprietary trading firms. See, e.g., FIA 1 Letter at 1 ("FINRA Membership would be costly to most proprietary trading firms"); PEAK6 Letter at 2 ("[FINRA registration is] overly costly and burdensome"); Hold Brothers Capital Letter at 2 ("[Costs of FINRA membership] would be unduly burdensome to smaller, less well funded Proprietary Traders"); Lakeshore Letter at 2-3; CTC Letter at 5-6; D&D Letter at 2; PTR Letter at 2; Options Market Makers Letter at 6; FIA 2 Letter at 5. Commenters also previously expressed concern that the application of the TAF in its current form to proprietary trading firms would be overly burdensome, but suggested that FINRA's proposed TAF amendment would mitigate this concern. See, e.g., HRT Letter at 5-6; FIA 1 Letter at 2; IEX Letter at 3; CTC Letter at 5; PEAK6 Letter at 3. Some commenters suggested a modification to FINRA's proposed amendment that would exclude from the TAF all of a firm's proprietary trading activity on an exchange of which it is a member. See, e.g., HRT Letter at 11. Apart from the TAF as it currently exists, the Commission does not believe that broker-dealer firms that join FINRA if proposed Rule 15b9-1 is adopted would be disproportionately impacted by the costs of FINRA membership compared to existing FINRA members that already incur those costs, and as discussed in the Economic Analysis, the Commission preliminarily believes that the costs would be justified by the considerable benefits of this proposal. In addition, some firms that could rely on Rule 15b9-1 nevertheless join FINRA voluntarily, which suggests that there are business interests satisfied by and benefits derived from FINRA membership that outweigh the costs of being a FINRA member, for at least some firms. Some commenters also raised the concern that FINRA may get paid twice for its regulatory oversight – once, directly from the FINRA membership, and again from the SROs that have outsourced regulatory oversight to FINRA through RSA agreements. See, e.g., SIFMA Letter at 3 and Lakeshore Letter at 3. The Commission notes that, as privately negotiated agreements between SROs, the fees set forth in RSAs are not subject to FINRA's rules or Commission review, and RSAs may be revised or terminated by the SRO parties thereto. By contrast, FINRA's rule-based fees are governed by Section 15A of the Act, which requires that they be equitably allocated among FINRA members and reasonable.

Exchange Act, respectively.[155] We encourage commenters to review that proposal to determine whether it might affect their comments on this proposing release.

Requests for Comment:

The Commission requests comment on all aspects of the proposed elimination of the de minimis allowance and proprietary trading exclusion as well as, in particular, on the following questions:

6. Are there exchange floor members that currently rely on the $1,000 de minimis allowance but not the proprietary trading exclusion? Are there exchange floor members that currently rely on the proprietary trading exclusion? If so, please describe the number and types of any such exchange floor members, and the nature and extent of their reliance. Also, please provide any available data on the amount and frequency of commissions or referral fees that floor members may continue to receive with respect to off-exchange transactions.
7. Should the Commission retain the de minimis allowance but eliminate the proprietary trading exclusion? If so, should the $1,000 threshold be changed? Why or why not? What should the threshold be? Should the de minimis allowance be modified in some other way? Would exchanges be able to appropriately monitor their members for compliance with an increased de minimis allowance? Would an increased de minimis allowance be an appropriate means of permitting hedging transactions that exchange members

155 See Securities Exchange Act Release No. 94524 (March 28, 2022), 87 FR 23054 (April 18, 2022).

may effect elsewhere than their member exchange(s) without triggering Section 15(b)(8)'s Association requirement?

8. Instead of eliminating the proprietary trading exclusion, should the Commission retain a modified version of it? If so, how should it be modified and why? How could the proprietary trading exclusion be modified such that there is appropriate and comprehensive SRO oversight of firms that trade securities otherwise than on an exchange of which they are member and that trading activity? For example, could the proprietary trading exclusion be modified such that a firm's reliance on it is contingent on the firm reporting its off-exchange securities transactions to the appropriate FINRA facility or TRACE? Would this suffice to enable the Commission to achieve the goals expressed herein, despite not providing FINRA with direct regulatory oversight of the firms?
9. If the de minimis allowance and proprietary trading exclusion are eliminated, as proposed, would some exchange floor members be required to become members of an Association? If so, how many? Please provide the basis of any estimate. What would be the effect on those firms?
10. To what extent do dealer firms that are not FINRA members and that trade securities otherwise than on an exchange of which they are a member rely on the proprietary trading exclusion? Where, other than an exchange where they are a member, do they typically effect securities transactions? On ATSs? Off-exchange otherwise than on an ATS? Another exchange where they are not a member? In what sort of dealer activity do these firms engage? For

example, do they typically provide liquidity or make markets? Do they typically remove liquidity? Do they engage in other types of trading activities?

11. If the de minimis allowance and proprietary trading exclusion are eliminated, as proposed, what would be the effect on dealer firms that currently rely on the proprietary trading exclusion? What, if anything, would be the impact on their businesses if they are required to register with an Association? Would business incentives change such that firms might adjust their business model by exiting the off-exchange market, moving transactions on-exchange, or leaving the markets altogether? Would firms alter their organizational structure or shift their proprietary trading activities to different or new affiliates? Would the effects on firms be different depending on what types of securities they trade?

12. Do commenters agree that some exchange member dealer firms trade proprietarily in U.S. Treasury securities as well as exchange-traded securities, and are not FINRA members in reliance on the proprietary trading exclusion? If the de minimis allowance and proprietary trading exclusion are eliminated, as proposed, what would be the effects on such firms? What, if anything, would be the impact on their U.S. Treasury securities trading business? Do commenters expect that these firms would alter their business model or organizational structure if the amendments proposed herein are adopted? If so, how? Would these firms shift their proprietary trading activities to different or new affiliates? Would increased price discovery reduce any

competitive advantages these firms have by observing other firms' trades and not reporting their own trades? Would this impact market costs borne by the investing public?

13. Do commenters believe that most exchange member dealer firms that effect proprietary securities transactions otherwise than on an exchange of which they are member would need to join FINRA as a result of the elimination of the de minimis allowance and proprietary trading exclusion? If so, would it help address the Commission's concerns regarding FINRA's lack of direct jurisdiction over such firms' off-member-exchange securities trading activity when they are not FINRA members? What are commenters' views as to the extent of FINRA's current ability to oversee off-member-exchange securities trading activity by dealer firms that are not FINRA members?
14. How do exchange SROs currently surveil or regulate their members' securities trading activity and conduct elsewhere than the exchange? Do exchange SRO efforts in this regard mitigate any need to rescind the de minimis allowance and proprietary trading exclusion? How would such an approach address the fact that TRACE reporting obligations apply only to FINRA members?
15. Are there concerns regarding how the TAF would apply to proprietary trading broker-dealer firms?
16. Are there concerns regarding the applicability of certain FINRA rules to solely proprietary trading broker-dealers, as opposed to those who face

customers? Which rules, and why? Are there benefits to applying FINRA rules to these broker-dealers?

B. Narrowed Criteria for Exemption from Association Membership

The Commission is proposing to add to Rule 15b9-1 a new paragraph (c) that would set forth two narrow circumstances in which a broker or dealer could continue to be exempt from Section 15(b)(8)'s Association membership requirement if it effects transactions in securities otherwise than on an exchange of which it is a member.[156] Specifically, following the existing paragraphs of Rule 15b9-1 that require that a broker or dealer be a member of a national securities exchange and carry no customer accounts (both of which paragraphs would be retained), the Commission proposes to add language that would state: "and, (c) Effects transactions in securities solely on a national securities exchange of which it is a member, except that with respect to this paragraph (c) . . ." The two proposed exceptions would follow in new paragraphs (c)(1) and (c)(2), and are discussed in turn below. Proposed paragraphs (c)(1) and (c)(2) of the amended rule are intended to provide more focused exemptions from Association membership for types of off-member-exchange activity that are similar to the off-member-exchange activities that Rule 15b9-1 was originally intended to cover, and that are consistent with the public interest and the protection of investors in accordance with Section 15(b)(9) of the Act.

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156 See proposed Rule 15b9-1(c). Relatedly, existing paragraph (a) of Rule 15b9-1 would remain the same except it would no longer be numbered as paragraph (a); existing paragraph (a)(1) would be renumbered as paragraph (a); and existing paragraph (a)(2) would be renumbered as paragraph (b). See proposed Rule 15b9-1.

1. Routing Exemption

In paragraph (c)(1) of Rule 15b9-1, the Commission proposes to provide an exemption from Association membership if a broker or dealer that meets the criteria of paragraphs (a) and (b) of the rule effects transactions in securities otherwise than on a national securities exchange of which it is a member that result solely from orders that are routed by a national securities exchange of which it is a member to comply with Rule 611 of Regulation NMS[157] or the Options Order Protection and Locked/Crossed Market Plan.[158] Relatedly, the Commission also proposes to eliminate from Rule 15b9-1 outdated references to the "Intermarket Trading System."[159]

The ITS Plan required each participant to provide electronic access to its displayed best bid and offer, and provided an electronic mechanism for routing orders, called commitments to trade, to access those displayed prices.[160] The ITS Plan provided each market limited access to

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157 17 CFR 242.611.

158 See proposed Rule 15b9-1(c)(1). See also Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) ("Options Linkage Plan"). In the 2015 Proposal, the Commission proposed to apply this exemption to orders routed to comply with Rule 611 but did not propose to apply this exemption to orders routed to comply with the Options Linkage Plan. Several commenters on the 2015 Proposal supported this proposed exemption for compliance with Rule 611. See, e.g., HRT Letter at 7; D&D Letter at 3; PTR Letter at 3; CHX Letter at 3-4; SIFMA Letter at 3-4. Commenters also suggested that the routing exemption should covers orders routed to comply with the Options Linkage Plan. See, e.g., Cboe Letter at 4; Cboe/NYSE/Nasdaq Letter at 3.

159 The Intermarket Trading System was an NMS plan, the full title of which was "Plan for the Purpose of Creating and Operating an Intermarket Communications Linkage Pursuant to Section 11A(c)(3)(B) of the Exchange Act of 1934" ("ITS Plan"). The ITS Plan was initially approved by the Commission in 1978. Exchange Act Release No. 14661 (April 14, 1978), 43 FR 17419 (April 24, 1978) ("ITS Plan Approval Order"). All national securities exchanges that traded exchange-listed stocks and the NASD were participants in the ITS Plan.

160 See ITS Plan Approval Order, supra note 159.

the other markets for the purpose of avoiding a trade-through[161] and locked or crossed markets.[162] The ITS Plan was eliminated in 2007 because it was superseded by Regulation NMS.[163] Thus, the references to the "Intermarket Trading System" in current paragraphs (b)(2) and (c) of Rule 15b9-1 are obsolete.

Today, Rule 611 of Regulation NMS requires trading centers, such as national securities exchanges, to establish, maintain, and enforce written policies and procedures reasonably designed to prevent trade-throughs in exchange-listed stocks, subject to certain exceptions.[164] In general, Rule 611 protects automated quotations that are the best bid or offer of a national securities exchange or an Association.[165] To facilitate compliance with Rule 611, national securities exchanges have developed the capability to route orders through brokers or dealers (many of which are affiliated with the exchanges) to other trading centers with protected quotations.[166] Similarly, in the options market, the Options Linkage Plan is a national market

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161 See 17 CFR 242.600(b)(94) (defining a "trade-through" under Regulation NMS); see also Options Linkage Plan, supra note 158 (defining "trade-through" in the options context).

162 A locked or crossed market occurs when a trading center displays an order to buy at a price equal to or higher than an order to sell, or an order to sell at a price equal to or lower than an order to buy, that is displayed on another trading center.

163 Notice of Filing and Immediate Effectiveness of the Twenty Fourth Amendment to the ITS Plan Relating to the Elimination of the ITS Plan, Exchange Act Release No. 55397 (March 5, 2007), 72 FR 11066 (March 12, 2007). Today, Regulation NMS contains an updated trade-through rule, and contemplates the use of private linkages by trading centers to route orders to avoid trade-throughs. 17 CFR 242.610-611.

164 17 CFR 242.611. See also 17 CFR 240.600(b)(95) (defining "trading center").

165 17 CFR 242.611.

166 See 17 CFR 242.600(b)(71) (defining "protected quotation" under Regulation NMS) and 17 CFR 242.600(b)(70) (defining "protected bid" and "protected offer" under Regulation NMS); see also Options Linkage Plan, supra note 158 (defining "protected bid" and protected offer" in the options context).

system plan that requires linkages between the options exchanges to protect the best-priced displayed quotes in the market and to avoid locked and crossed markets.[167] The Options Linkage Plan includes written policies and procedures that provide for order protection and address locked and crossed markets in eligible options classes.[168]

The proposed rule would continue to accommodate securities transactions away from a broker's or dealer's member exchange(s) that are to comply with these regulatory requirements. An exchange member may at times seek to effect a securities transaction on that exchange at a price that would trade through a protected quotation displayed on another trading center, such as another exchange or FINRA's ADF. In such a case, the exchange may route the member's order (if the exchange does not reject it), through a routing broker-dealer, to that other trading center to access the protected quotation. Moreover, if, for example, an ATS were to display a protected quotation on FINRA's ADF, absent the proposed exemption, a broker or dealer would have to join FINRA in order to have access to all protected quotations, even if the broker or dealer already is a member of every exchange on which it effects securities transactions.[169]

In essence, a broker or dealer may, as a necessary part of its business trading on exchanges of which it is a member and in light of today's market structure, effect securities transactions elsewhere than an exchange where it is a member solely as a consequence of routing

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167 See Options Linkage Plan, supra note 158.

168 Id.

169 See HRT Letter at 7 (stating that "if an ATS were to display a protected quote on FINRA's ADF, absent an exemption, a Non-Member would not have access to the protected quotations without registering with FINRA" and asserting that allowing exempt firms to have access to all protected quotations is critical because it affects their ability to trade on exchanges of which they are members). See also SIFMA Letter at 3 (suggesting that the Commission clarify the exemption and whether it applies to non-floor exchange members whose orders are routed by the exchange to an off-exchange venue).

by its member exchange(s) to comply with the requirements of Rule 611 of Regulation NMS or the Options Linkage Plan. The proposed rule would not require Association membership as a result of such transactions. On the contrary, it would be consistent with Section 15(b)(9)'s goal of protecting investors and the public interest if transactions effected solely to comply with these regulatory requirements, via routing by the broker's or dealer's member exchange(s), do not trigger Section 15(b)(8)'s Association membership requirement for a broker or dealer that otherwise limits its securities transactions to an exchange of which it is a member (or to stock transactions that are covered by the stock-option order exemption discussed below). The proposed routing exemption would serve the limited, narrowly defined purpose of facilitating compliance with intermarket order protection requirements.[170]

The Commission also believes that it would be consistent with the protection of investors and the public interest to permit reliance on this exemption only where the routing is performed

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170 One commenter stated that the routing exemption should be "expanded to include all exchange-based routing activity, including, but not limited to, routing effected for Regulation NMS-compliance and best execution purposes" and that the proposal "does not contemplate the full array of legitimate and necessary exchange-based routing activity." See CHX Letter at 3. The commenter asserted that because all exchange routing functionalities must be approved by the Commission, any type of exchange routing would be consistent with the purposes of the Act and should be covered by the proposed exemption. Id. at 3-4. In response to this comment, the Commission preliminarily believes that many exchange-offered routing functionalities are not necessary to facilitate an exchange member's trading on the exchange. In addition, the Commission is unaware of any exchange-offered routing options that are specifically designated as being for best execution purposes. An exchange member may utilize the exchange's routing functionality to assist in meeting its best execution obligations, but this would not appear limited to any particular exchange-offered routing option. The commenter's suggested expansion of the proposed routing exemption could create a gap in the FINRA oversight intended to be achieved under the proposal if the exchange member could rely on its member exchange's router to execute significant volume on other markets where it is not a member without joining FINRA.

by a national securities exchange of which the broker or dealer is a member. This limitation would help ensure that the broker's or dealer's member exchange has visibility into these routing transactions and thus is better able to provide effective SRO oversight of its member's activity that is related to its trading on the exchange and may not be overseen by another SRO if the member is exempt from Association membership under amended Rule 15b9-1.[171] In this context, the exemption would be applicable where the broker's or dealer's member exchange utilizes the services of a designated broker-dealer (which could be affiliated or unaffiliated with the exchange) to perform the exchange's outbound routing, as the Commission understands that this type of arrangement is typical among exchanges.

A commenter on the 2015 Proposal sought clarity as to whether the exemption would apply to routing broker-dealers that are affiliated with national securities exchanges that are used by exchanges to conduct routing to other trading centers.[172] The commenter pointed out that the Commission has required these affiliated routing broker-dealers to operate as "facilities" of their

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171 Some commenters on the 2015 Proposal suggested that the routing exemption should not be limited to where the broker's or dealer's member exchange's routing mechanism is utilized, and that the Commission also should provide relief to broker-dealers that route orders to access protected quotations on away exchanges without utilizing the linkage routing mechanism offered by a home exchange. See Cboe Letter at 4; Cboe/NYSE/Nasdaq Letter at 3. The Commission does not believe this would be appropriate because it could permit scenarios in which there is insufficient SRO oversight of the entirety of the broker-dealer's trading activity. By way of example, if a broker-dealer were a member of some exchanges but not others and not a FINRA member, and the broker-dealer could rely on the exemption when routing orders to access protected quotations on non-member exchanges or off-exchange in order to prevent a trade-through on one of its member exchanges, the Commission believes that it is possible that there would not be an SRO responsible for and that could exercise jurisdiction over the broker-dealer's trading activity away from its member exchange(s).

172 See SIFMA Letter at 3-4.

respective exchanges, which set forth rules that require the exchange to arrange for the routing broker-dealer to be overseen by a non-affiliated SRO, and which in practice is FINRA.[173] The commenter requested that the Commission clarify that the exemption from FINRA registration under Rule 15b9-1 would not apply to a broker-dealer affiliated with a national securities exchange that routes orders on behalf of the exchange for the purpose of accessing quotations in other trading centers.[174] In response, proposed Rule 15b9-1 would provide an exemption from Section 15(b)(8) of the Act's Association membership requirement for routing broker-dealers that meet the conditions for the exemption. However, proposed Rule 15b9-1 would not provide routing broker-dealers with an exemption from the rules of an exchange that are applicable to routing broker-dealers that operate as facilities of that exchange (and that the exchange uses to conduct routing to other trading centers). As is the case today, if an exchange's routing broker-dealer is covered by amended Rule 15b9-1, if adopted, then the routing broker-dealer would qualify for the exemption from Section 15(b)(8) afforded by the rule. But the routing broker-dealer would still be required to comply with the applicable rules of any exchange for which it performs outbound routing services, including those requiring the routing broker-dealer to be overseen by an unaffiliated SRO such as FINRA.[175]

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173 Id.

174 Id. (expressing concern as to whether "an exchange-affiliated routing broker-dealer could restrict its activities to accessing protected quotations on other exchanges and could therefore avoid FINRA membership").

175 See, e.g., Cboe BZX Exchange, Inc. Rule 2.11 (Cboe Trading, Inc. as Outbound Router); NYSE Rule 17(c) (Operation of Routing Broker); Nasdaq Rule 4758(b) (Routing Broker).

The Commission requests comment on all aspects of the proposed routing exemption in amended Rule 15b9-1. In particular, the Commission seeks responses to the following questions:

17. What are commenters' views on the proposed routing exemption? How, if at all, should the proposed routing exemption be modified?
18. Is the scope of the proposed routing exemption sufficient to provide relief for all securities transactions effected elsewhere than on an exchange of which a broker or dealer is a member that might be effected to comply with Rule 611 of Regulation NMS and the Options Linkage Plan? If not, how should it be changed?
19. Should the proposed routing exemption be broadened to cover transactions beyond those that are to comply with Rule 611 of Regulation NMS and the Options Linkage Plan? If so, what types of additional transactions should be covered and why? For example, should the proposed routing exemption be broadened such that it covers routing by an exchange for any purpose and pursuant to any of the exchange's available routing functionalities? Should the proposed routing exemption be narrowed so that it does not cover transactions to comply with Rule 611 or the Options Linkage Plan? Should the proposed routing exemption be eliminated in its entirety?
20. Are there other off-exchange transactions that a broker or dealer might effect in order to comply with regulatory requirements? If so, please describe those transactions and the relevant regulatory requirements. Should there be an exemption in amended Rule 15b9-1 that applies to any such transactions?

21. Should the proposed routing exemption also cover broker-dealer routing to access protected quotations without using the member exchange's routing mechanisms? Why or why not?

22. As discussed above, the Commission preliminarily believes that the proposed routing exemption from Section 15(b)(8)'s Association membership requirement does not exclude a routing broker that operates as the facility of an exchange, but such a routing broker would still be required to comply with the rules of the exchange, including exchange rules requiring that the routing broker be overseen by an SRO that is not affiliated with the exchange. Do commenters agree with this? Should Rule 15b9-1 be amended in some way such that it excludes or applies differently to routing brokers that operate as the facility of an exchange? Why or why not? Should the proposed routing exemption apply where the exchange uses a routing broker, whether affiliated or unaffiliated? Should the routing exemption apply only where the exchange uses an affiliated routing broker? Should the routing exemption apply only where the exchange uses an unaffiliated routing broker?

2. Stock-Option Order Exemption

In paragraph (c)(2) of amended Rule 15b9-1, the Commission proposes to provide an exemption from Association membership if a broker or dealer that meets the criteria of paragraphs (a) and (b) of the rule effects transactions in securities otherwise than on a national securities exchange of which it is a member, with or through another registered broker or dealer,

that are solely for the purpose of executing the stock leg of a stock-option order.[176] Proposed paragraph (c)(2) also would require that a broker or dealer seeking to rely on this proposed exemption establish, maintain, and enforce written policies and procedures reasonably designed to ensure and demonstrate that such transactions are solely for the purpose of executing the stock leg of a stock-option order, and that the broker or dealer preserve a copy of its policies and procedures in a manner consistent with 17 CFR 240.17a-4 until three years after the date the policies and procedures are replaced with updated policies and procedures.[177]

The Commission understands that there are firms that trade stock-option orders whose business is focused on one or more options exchanges of which they are a member, and whose trading elsewhere is primarily to effect the execution of stock orders to facilitate their stock-option order business. In the Commission's preliminary view, these firms' stock trading activity is for a limited purpose and ancillary to their primary business handling stock-option orders on an options exchange of which they are member. As discussed below, there is a close link between the stock component transaction of a stock-option order and the relevant options exchange. As such, the proposed rule would permit these types of firms to continue their stock-option order trading business without being required to join stock exchanges or an Association solely in order to effect the execution of the stock legs of stock-option orders that they handle.

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176 See proposed Rule 15b9-1(c)(2). The 2015 Proposal did not include this type of exemption. Several commenters suggested that it be added to the amended rule. See, e.g., Letter from Elizabeth K. King, Secretary and General Counsel, NYSE and Joan C. Conley, Senior Vice President and Corporate Secretary, NASDAQ OMX Group, Inc. (June 4, 2015) ("NYSE/Nasdaq Letter") at 2-4; D&D Letter at 1-2; PTR Letter at 1-2; Cboe Letter at 3; Cboe/NYSE/Nasdaq Letter at 4; Lakeshore Letter at 2.

177 See proposed Rule 15b9-1(c)(2).

As noted above, the Commission estimates that, in 2021, 50 of the 66 firms identified as registered broker-dealers and exchange members but not FINRA members initiated options order executions.[178] The Commission estimates that seven of the firms that initiated options order executions also effected the execution of stock leg transactions, and therefore could potentially rely on the proposed stock-option order exemption to the extent that they effect the stock leg executions off-exchange or on an exchange where they are not a member. Because the broker or dealer relying on proposed Rule 15b9-1(c)(2) would not itself be a member of an exchange on which such stock transactions are executed, or a member of an Association, such stock leg transactions would need to be effected with or through another registered broker or dealer that is a member of the exchange where the transactions are executed or a member of an Association (or both).

Options exchanges define the term "stock-option order" in their rules.[179] Further, as far as the Commission is aware, all options exchanges accept a stock-option order only if it complies

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178 See supra note 81.

179 See, e.g., Cboe Rule 1.1 (defining "stock-option order" as "an order to buy or sell a stated number of units of an underlying or a related security coupled with either (a) the purchase or sale of option contract(s) on the opposite side of the market representing either the same number of units of the underlying or related security or the number of units of the underlying security necessary to create a delta neutral position or (b) the purchase or sale of an equal number of put and call option contracts, each having the same exercise price and expiration date, and each representing the same number of units of stock as, and on the opposite side of the market from, the underlying or related security portion of the order. For purposes of electronic trading, the term "stock-option order" has the meaning set forth in Rule 5.33."); Cboe Rule 5.33(b)(5) (defining a "stock-option order" as "the purchase or sale of a stated number of units of an underlying stock or a security convertible into the underlying stock ("convertible security") coupled with the purchase or sale of options contract(s) on the opposite side of the market representing either (i) the same number of units of the underlying stock or convertible security or (ii) the number of units of the underlying stock necessary to create a delta neutral position, but in no case in a ratio greater than eight-to-one (8.00), where the ratio represents the total number of

with the Qualified Contingent Trade ("QCT") Exemption ("QCT Exemption") from Rule 611(a) of Regulation NMS.[180] For purposes of relying on the exemption provided by proposed Rule 15b9-1(c)(2), a broker or dealer should adhere to the stock-option order definition of the options

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units of the underlying stock or convertible security in the option leg(s) to the total number of units of the underlying stock or convertible security in the stock leg"). See also, e.g., MIAX Rule 518(a)(5); MIAX Emerald Rule 518(a)(5); Nasdaq Options 3, Section 14(a)(i); Nasdaq PHLX Options 3, Section 7(b)(13); Nasdaq ISE Options 3, Section 14(a)(5); Nasdaq MRX Options 3, Section 14(a)(5); Nasdaq BX Chapter 5, Section 27(a)(v)(1) of the "Grandfathered Rules" of the Boston Stock Exchange, Inc.; NYSE Arca Rule 6.62-O(h)(1); and NYSE American Rule 900.3NY(h)(1).

180 See, e.g., Cboe Rule 5.33, Interpretations and Policies .04 Stock Option Orders (stating that a user may only submit a stock-option order if it complies with the QCT Exemption and that a user submitting a stock-option order represents that it complies with the QCT Exemption); Supplementary Material to Nasdaq ISE Options 3, Section 14 (stating that "[m]embers may only submit Complex Orders in Stock-Option Strategies and Stock-Complex Strategies if such Complex Orders comply with the Qualified Contingent Trade Exemption from Rule 611(a) of Regulation NMS under the Exchange Act" and that "[m]embers submitting Complex Orders in Stock-Option Strategies and Stock-Complex Strategies represent that they comply with the Qualified Contingent Trade Exemption") and Commentary .01 to MIAX Rule 518 (stating that "[m]embers may only submit stock-option orders if such orders comply with the Qualified Contingent Trade Exemption from Rule 611(a) of Regulation NMS under the Securities Exchange Act of 1934" and that "[m]embers submitting such complex orders represent that such orders comply with the Qualified Contingent Trade Exemption"). A qualified contingent trade is "a transaction consisting of two or more component orders, executed as agent or principal where: (1) at least one component order is in an NMS stock; (2) all components are effected with a product or price contingency that either has been agreed to by the respective counterparties or arranged for by a broker-dealer as principal or agent; (3) the execution of one component is contingent upon the execution of all other components at or near the same time; (4) the specific relationship between the component orders (e.g., the spread between the prices of the component orders) is determined at the time the contingent order is placed; (5) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or since cancelled; and (6) the transaction is fully hedged (without regard to any prior existing position) as a result of the other components of the contingent trade." Securities Exchange Act Release No. 54389 (August 31, 2006), 71 FR 52829 (September 7, 2006); see also Securities Exchange Act Release No. 57620 (April 4, 2008), 73 FR 19271 (April 9, 2008).

exchange where the stock-option order is handled and of which the broker or dealer is a member.[181] Specifically, the broker or dealer could rely on that definition to determine whether, for purposes of amended Rule 15b9-1(c)(2), an order is in fact a stock-option order and a stock order is in fact the stock leg of a stock-option order. Moreover, the exemption would apply regardless of whether the component legs of a stock-option order are executed electronically, on the physical exchange floor, or through a combination of both. The Commission believes that approaching the proposed stock-option order exemption in this way should minimize disruptions to the markets for stock-option orders by minimizing the degree to which brokers and dealers that trade such orders would need to alter their business in order to rely on the proposed exemption.

Relying on the options exchange's definition also should enhance an exchange's ability to monitor whether its members are appropriately relying on the proposed exemption and thereby enhance its ability to provide effective SRO oversight of its members' stock-option order trading activity. Under options exchange rules, an exchange member submitting a stock-option order to the exchange must designate to the exchange one or more specific broker-dealers: (i) that are not affiliated with the exchange; (ii) with which the exchange member has entered into a brokerage agreement; (iii) that the exchange has identified as having connectivity to electronically communicate the stock components of stock-option orders to stock trading venues; and (iv) to which the exchange will electronically communicate the stock component of the stock-option

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181 Presumably, an options exchange would accept only those stock-option orders that meet the exchange's definition thereof. In addition, the Commission's understanding is that, currently, consistent with options exchange definitions, a stock-option order contains only one stock leg. See supra note 179. Therefore, the proposed stock-option order exemption is designed to cover stock-option orders with only one stock leg.

order on behalf of the member.[182] The option exchange's execution of the stock-option order is contingent on the exchange's receipt from the designated broker-dealer of an execution report for the stock component transaction confirming that the transaction has occurred.[183] In light of these rules, the Commission preliminarily believes that there is a close link between the stock component transaction of a stock-option order and the relevant options exchange. Accordingly, the Commission believes that this proposed exemption would serve the limited, narrowly defined purpose of facilitating the execution of stock-option orders consistent with options exchange rules and that the options exchange would be able to monitor and oversee the totality of the securities trading activity of any of its members that rely on the exemption.

The Commission preliminarily believes that the exchange's oversight capabilities will be further enhanced, consistent with the public interest and protection of investors, by requiring written policies and procedures in connection with the stock-option exemption in proposed paragraph (c)(2) of the amended rule. This requirement would help facilitate exchange SRO supervision of brokers and dealers relying on the stock-option order exemption because it would provide an efficient and effective way for the relevant options exchange to assess compliance with the proposed exemption. Moreover, the Commission preliminarily believes that requiring brokers and dealers to develop written policies and procedures would provide sufficient

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182 See, e.g., Cboe Rule 5.33(l) and Interpretations and Policies .04; Nasdaq ISE Options 3, Section 7 and Supplementary Material .01, Options 3, Section 14 and Supplementary Material .07; and MIAX Rule 518 and Commentary .01.

183 See, e.g., Cboe Rule 5.33(l); Nasdaq ISE Options 3, Section 7 and Supplementary Material .01, Options 3, Section 14 and Supplementary Material .07; and MIAX Rule 518 and Commentary .01.

flexibility to accommodate potentially varying business models of brokers and dealers that effect stock-option orders and may seek to rely on this exemption.

Such written policies and procedures must be reasonably designed to ensure and demonstrate that the broker's or dealer's securities transactions elsewhere than on an exchange of which it is a member are solely for the purpose of executing the stock leg of a stock-option order. Accordingly, a broker or dealer seeking to rely upon the proposed stock-option order exemption must establish, maintain, and enforce written policies and procedures reasonably designed to ensure and demonstrate that such transactions are solely for the purpose of executing the stock leg of a stock-option order. For example, the broker or dealer could maintain documentation that demonstrates its compliance with the stock-option order requirements of any options exchange of which it is a member and where it effects the execution of stock-option orders. Indeed, in addition to the Commission, the options exchange of which the broker or dealer is a member and where the stock-option order is handled would be able to enforce compliance with the stock-option order exemption. In the context of routine examinations of its members, the options exchange generally would review the adequacy of its members' written policies and procedures and assess whether its members' off-member-exchange transactions comply with those written policies and procedures as well as the terms of the exemption itself, as set forth in amended Rule 15b9-1.[184]

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184 Section 19(g)(1) of the Act, 15 U.S.C. 78s(g), among other things, requires every SRO to examine for and enforce compliance by its members and associated persons with the Act, the rules and regulations thereunder, and the SRO's own rules, unless the SRO is relieved of this responsibility pursuant to Section 17(d), 15 U.S.C. 78q(d) or Section 19(g)(2), 15 U.S.C. 78s(g)(2), of the Act.

Finally, a broker or dealer seeking to rely on the stock-option order exemption would be required to preserve a copy of its policies and procedures in a manner consistent with Rule 17a-4 under the Exchange Act until three years after the date the policies and procedures are replaced with updated policies and procedures.[185] Accordingly, a broker or dealer would be required to keep the policies and procedures relating to its use of this proposed exemption as part of its books and records while they are in effect, and for three years after they are updated.

The Commission requests comment on all aspects of the proposed stock-option order exemption in Rule 15b9-1. In particular, the Commission seeks responses to the following questions:

23. Is the proposed stock-option order exemption necessary and appropriate? Why or why not? How, if at all, should this proposed exemption be modified?
24. Is the scope of the proposed stock-option order exemption sufficient to provide for all off-member-exchange transactions that might be effected by a broker or dealer as a necessary component of handling stock-option orders? If not, how should it be changed?
25. Should the proposed stock-option order exemption be broadened to cover transactions beyond those necessary to complete stock-option orders? If so, what types of additional transactions should be covered and why? Should the proposed exemption be narrowed in some way? Should the proposed stock-option order exemption be eliminated in its entirety?

185 See, e.g., 17 CFR 240.17a-4(e)(7).

26. Is the Commission's understanding correct that all stock-option orders must be QCTs? If not, what types of stock-option orders are not required to be QCTs? Should they be covered by the proposed exemption?
27. The proposed stock-option order exemption is limited to transactions effected with or through another registered broker-dealer. Are there circumstances where a broker or dealer that is not a FINRA member might not need to effect the execution of the stock leg of a stock-option order with or through another registered broker-dealer? Are there circumstances in which a broker or dealer that is not a FINRA member might need to effect the execution of the stock leg of a stock-option order with or through a party that is a registered broker-dealer but not a member of an exchange where the stock leg is executed, or not a member of an Association if the stock leg is not executed on an exchange? If so, please describe the nature and extent of such transactions.
28. Stock transactions effected in reliance on the exemption would still be subject to required transaction reporting. Would such reliance impede required transaction reporting in any way?
29. As proposed, the stock-option order exemption would cover stock-option orders with one stock leg and any number of options legs. Is this appropriate? Should the proposed stock-option order exemption be limited to two-leg stock-option orders where one leg is a stock and the other leg is an option? Why or why not? Do firms execute stock-option orders that contain multiple stock legs? If so, should the stock legs of such stock-option orders be covered by the proposed exemption?

C. No Floor-Member Hedging Exemption

As discussed above, the Commission adopted Rule 15b9-1 so that an exchange member's limited trading activity ancillary to its floor business on a single national securities exchange would not necessitate Association membership in addition to exchange membership.[186] Since that time, the securities markets have evolved to include significant, cross-market and off-exchange electronic proprietary trading as a primary business model. This business model did not exist when the Commission adopted Rule 15b9-1 in its current form, nor did firms engage in extensive off-member-exchange proprietary trading activity while exempt from Association membership by virtue of Rule 15b9-1.

Unlike today's proposed amendments, the 2015 Proposal would have provided an exemption from Association membership for a dealer that is an exchange member, carries no customer accounts, conducts business on the floor of a national securities exchange, and effects transactions off the exchange, for the dealer's own account with or through another registered broker or dealer, that are solely for the purpose of hedging the risks of its floor-based activity.[187] The Commission proposed that the hedging exemption be limited to a dealer's floor-based trading on a national securities exchange, and understood then that dealers that limit their activities to an exchange's physical trading floor tend to be specialists or floor brokers based on the floor of an individual exchange.[188] That proposed hedging exemption was intended to be consistent with the original intent of Rule 15b9-1 to accommodate only limited proprietary

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186 See supra notes 60 - 62 and accompanying text.

187 Currently, NYSE Arca Options, NYSE American Options, Nasdaq Phlx, Cboe, NYSE, and BOX Exchange have physical exchange floors.

188 See 2015 Proposing Release, supra note 6, 80 FR at 18047.

trading activity elsewhere than a broker's or dealer's member exchange(s) that is ancillary to the broker's or dealer's primary trading activity on its member exchange(s). But based on data available to the Commission today that was not available in 2015, the Commission believes that no dealers currently trade in a manner that would enable reliance on the hedging exemption as proposed in the 2015 Proposal, i.e., no dealer's trading on an exchange of which it is a member is solely on the exchange's floor. Accordingly, the re-proposed rule does not include the hedging exemption included in the 2015 Proposal.[189]

Some commenters supported the proposed hedging exemption in the 2015 Proposal, but suggested that the exemption should not be limited to a dealer operating solely on a physical exchange floor, and also should cover off-member-exchange hedging transactions by dealers that trade electronically on their member exchange(s).[190] The Commission preliminarily believes that an exemption of this nature might swallow the amended rule, as proposed, and would not be appropriate. As discussed above, electronic trading dealer firms effect securities transactions proprietarily across market centers as a primary business model, including to a significant degree in the off-exchange market and on exchanges of which they are not a member.[191] The Commission acknowledges that it is unlikely that all of these firms' securities trading activity away from their member exchanges is to hedge their securities trading activity on their member exchanges. Thus, the off-member-exchange transaction volume attributable to these firms likely

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189 As described above, to the extent a stock transaction is a component of a stock-option order, and the broker or dealer handling the stock-option order otherwise meets the requirements of the proposed amended rule, that stock transaction would not trigger Section 15(b)(8)'s Association membership requirement.

190 See, e.g., CHX Letter at 3; CTC Letter at 7; Cboe Letter at 2-3; Options Market Makers Letter at 4; and Cboe/NYSE/Nasdaq Letter at 2-3.

191 See supra Section II.B.

overstates the volume of transactions that would be attributable to firms who could rely on a hedging exemption that covered electronic trading activity as contemplated by commenters. The Commission cannot reliably discern from available data what off-member-exchange securities transactions effected by these firms are for hedging purposes and what transactions are not. But the Commission preliminarily believes that there are proprietary trading dealer firms that trade electronically and in significant volumes, including off any exchange where they are a member, which could potentially meet the criteria of a hedging exemption that covered electronic trading activity. Indeed, in light of the concentration of off-member-exchange securities transaction volume among certain firms, as discussed above, even if only a small number of firms could rely on a hedging exemption that covered electronic trading activity, it could translate into significant trading activity that would not be subject to direct FINRA oversight. This would not be consistent with the protection of investors or the public interest, or with the historical rationale for Rule 15b9-1.

Commenters more broadly suggested that the 2015 Proposal did not adequately consider options market makers or their hedging needs.[192] Some of these commenters' concerns appear to center on firms' needs in relation to their handling of stock-option orders.[193] As such, these

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192 See, e.g., Options Market Makers Letter at 1; CTC Letter at 1; CHX Letter at 3; Cboe Letter at 2-3; Cboe/NYSE/Nasdaq Letter at 2-3; NYSE/Nasdaq Letter at 2-4; Letter from Reps. Bill Foster and Randy Hultgren, Members of U.S. Congress (Nov. 15, 2016) at 2.

193 See, e.g., NYSE/Nasdaq Letter at 2-4; Cboe Letter at 3; Cboe/NYSE/Nasdaq Letter at 4. For example, one commenter expressed concern that the 2015 Proposal would "unintentionally require [options] floor brokers, which have a business focused on the floor of an exchange in which they are members, to become members of FINRA" and specifically noted that this "could restrict floor brokers from fulfilling stock-option orders…[b]ecause the stock component of a stock-option order cannot be executed on the options exchange of which a floor broker is a member." NYSE/Nasdaq Letter at 2. This commenter suggested that any amendment "maintain floor brokers' ability to route the

concerns could be mitigated by the stock-option order exemption that the Commission is proposing to include in amended Rule 15b9-1.[194]

The Commission requests comment on its re-proposed approach of not providing a hedging exemption in amended Rule 15b9-1. In particular, the Commission seeks responses to the following questions:

30. Should the Commission adopt a hedging exemption outside the context of the proposed stock-option order exemption? Why or why not? Would it be apparent whether a securities transaction is for hedging purposes?

31. Should the Commission adopt a hedging exemption (in addition to the proposed stock-option order exemption) that applies to a dealer that is a member of multiple exchanges? Why or why not? Should the Commission allow firms to rely on any such exemption only if they effect hedging transactions in securities on exchanges where they are not a member (i.e., off-exchange transactions, even if solely for purposes of hedging a single

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stock leg of a stock-option order for execution on another market by a member of the away market without requiring the floor broker to become a member of FINRA." NYSE/Nasdaq Letter at 4; see also Lakeshore Letter at 2.

194 In addition, Section 15(b)(9) of the Act provides the Commission with the authority, by rule or order, and as it deems consistent with the public interest and the protection of investors, to conditionally or unconditionally exempt from the requirements of Section 15(b)(8) any broker or dealer or class of brokers or dealers. Accordingly, if a dealer or class of dealers believes that it should be exempted from the requirements of Section 15(b)(8) in a manner that is not provided by amended Rule 15b9-1, it may seek an exemption from the Commission, by order, pursuant to Section 15(b)(9). For example, the Commission may consider granting such an exemption, where appropriate, if a dealer or class of dealers chooses to limit its exchange trading activity to the physical floor of an exchange of which it is a member, but must effect limited securities transactions elsewhere for its own account in order to facilitate its exchange-floor business.

exchange member's trading activity on that exchange, would not be covered by the exemption)? Why or why not?

32. Should the Commission adopt a hedging exemption that covers off-member-exchange transactions to hedge on-member-exchange electronic transactions and physical exchange floor transactions, just on-member-exchange physical exchange floor transactions or just on-member-exchange electronic transactions? Why would one of these possible approaches be preferable to another? Under each possible approach, how difficult would it be to discern what off-member-exchange securities transactions by electronic trading firms are for hedging purposes? The Commission specifically seeks data that demonstrates the extent to which exchange member dealer firms trade elsewhere than on their member exchange(s) in order to hedge the risks of their trading activities on their member exchange(s).
33. Are there non-floor-based exchange members that today focus their business activities on a single exchange? Are there floor-based exchange members that today focus their business activities on a single exchange? If so, what is the nature of each firm's business activities?
34. Should the Commission adopt a hedging exemption in the amended rule that requires a dealer seeking to rely on the exemption to establish, maintain, and enforce written policies and procedures reasonably designed to ensure and demonstrate that its off-member-exchange hedging transactions reduce or otherwise mitigate the risks of the financial exposure the dealer incurs as a result of its on-member-exchange activity? Why or why not? What would be

the costs of establishing, maintaining, and enforcing the policies and procedures, and any related record-keeping requirements? How are such costs determined? Please provide evidence of the nature, timing, and extent of such costs. Would such costs deter dealers from relying on the hedging exemption? Are there more efficient and effective alternatives to a policies and procedures approach? If so, what are they? Please describe in detail.

35. Would current exchange surveillance and enforcement mechanisms be effective to monitor off-member-exchange trades that would be executed pursuant to a possible hedging exemption? Could this be accomplished through 17d-2 plans and RSAs? Please explain. Would exchanges otherwise have the ability to assess dealers' compliance with a hedging exemption? If not, should the Commission require additional reporting by registered broker-dealers acting as an agent for dealers relying on a hedging exemption? Please explain.

36. Should the Commission adopt a hedging exemption that is subject to quantitative limits on the volume of hedging transactions that a firm may execute in reliance on such an exemption? Could qualitative or quantitative requirements assist in identifying off-member-exchange activity that is solely for the purpose of hedging? Please explain.

37. Should the Commission adopt a hedging exemption that requires the exchange member to retain records demonstrating how each off-member-exchange transaction complies with its policies and procedures? Why or why not? What would be the associated costs, and what is the basis for those costs?

Would the cost associated with recordkeeping on a transaction-by-transaction basis be overly burdensome, impractical, or unnecessary?

38. Should the Commission adopt a hedging exemption that requires dealers to make a certification in connection with their reliance on the hedging exemption? Why or why not? If a certification should be required, what would be the key elements thereof? How frequently should the certification be made? Who should make it? What qualifications, if any, to such certification might be appropriate? For example, should firms be required to certify that they have a reasonable basis to believe that they are in compliance with a hedging exemption? Or should they be required to make such a certification to the best of their knowledge? Is there a different standard that would be appropriate? Should the certification be made in conjunction with an internal compliance review? If so, what type of internal compliance review should be conducted?
39. Would not adopting a hedging exemption affect liquidity on any national securities exchange?

IV. Effective Date and Implementation

The Commission recognizes that firms may need time to comply with any amended Rule 15b9-1 if adopted. In particular, they may need time to become a member of an Association. As noted previously, FINRA is currently the only Association. To become a FINRA member, a broker or dealer must complete FINRA's New Member Application and participate in a pre-

membership interview.[195] The broker or dealer and its associated persons must comply with FINRA's registration and qualification requirements.[196] The amount of time that it takes to become a FINRA member depends on a number of factors, including the nature of the broker's or dealer's business, the level of complexity or uniqueness of the firm's business plan, the number of associated persons that the firm employs, and whether the firm has an affiliate that is already a member of FINRA.[197] The Commission understands that, on average, the FINRA membership application process takes approximately six months.

Alternatively, broker-dealer firms that currently rely on Rule 15b9-1 and carry no customer accounts may choose to adjust their business model or organizational structure such that they effect securities transactions solely on national securities exchanges of which they are a member, and therefore comply with Section 15(b)(8) without needing to join FINRA or rely on any amended version of Rule 15b9-1 if adopted. This may require such firms to become a member of additional exchanges upon which they trade. Or, firms may need time to adjust their business models such that their securities transactions elsewhere than exchanges of which they are a member comply with the proposed amendments to paragraphs (c)(1) or (c)(2) if adopted, including establishing policies and procedures that would be required by proposed paragraph (c)(2). More broadly, broker-dealer firms may need to modify their systems or take other steps to achieve compliance with any amended rule if adopted.

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195 See FINRA.org, How to Apply, available at https://www.finra.org/registration-exams-ce/broker-dealers/how-apply (last visited on July 22, 2022).

196 See FINRA Rule 1010 – Electronic Filing Requirements and Uniform Forms, which sets out the substantive standards and procedural guidelines for the FINRA membership application and registration process.

197 See Section VI.C.2, infra, discussing the costs of joining FINRA.

The Commission preliminarily believes that one year after publication in the Federal Register of any amended version of Rule 15b9-1 that the Commission may adopt should provide firms with enough time to comply.[198] Therefore, the Commission proposes that the compliance date for amended Rule 15b9-1 would be one year after publication of any final rule in the Federal Register. The Commission solicits comment on the adequacy of this proposed implementation timeline. In particular, the Commission seeks responses to the following questions:

40. Would one year after publication of any final rule in the Federal Register provide firms with sufficient time to comply with amended Rule 15b9-1, if adopted? Would firms be in a position to comply with any final, amended rule earlier than one year after publication? Would a compliance period that

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198 In the 2015 Proposal, supra note 6, the Commission solicited comment on the appropriate length of time that it should provide firms to comply with the then-proposed amended version of Rule 15b9-1. In this regard, the Commission also solicited comment on the FINRA membership process. Some commenters stated that one year generally is sufficient to join FINRA. See, e.g., IEX Letter at 3. Other commenters requested more time or requested that the Commission require FINRA to develop a "fast track" application process. See, e.g., FIA 2 Letter at 5. Another commenter suggested a waiver process for a proprietary trading firm that is registered with the Commission and an SRO, if the firm's information has not materially changed from the time it registered with such entities, and so long as the firm remains in good standing with the Commission and other regulators. See Peak6 Letter at 2. FINRA stated that it tentatively believed that most broker-dealer firms that are not FINRA members "are already members of an exchange and are engaged solely in proprietary trading activity" and would be candidates for its "fast track/triage program" which has an average processing time of 60 days for membership. See FINRA Letter at 5-6. As reflected in the requests for comment in this section, the Commission again solicits comment from FINRA and exchanges regarding the length of time of the membership application and approval process, and from any interested parties generally regarding the appropriate length of time for compliance with the proposed amendments to Rule 15b9-1 if they are adopted.

is shorter or longer than one year be more appropriate? If so, how long should the revised compliance period be and why?

41. Would one year after publication of any final rule in the Federal Register provide firms with sufficient time to comply with Section 15(b)(8) of the Act by joining an Association? Would one year after publication of any final rule in the Federal Register provide firms that do not trade securities off-exchange with sufficient time to comply with Section 15(b)(8) of the Act by becoming a member of all national securities exchanges where they trade securities (if they are not already a member of all such exchanges)?
42. How long is the registration process with FINRA typically? How long would it take FINRA to process new membership applications from firms that join FINRA as a result of the proposed amendments, considering that many such firms may submit applications close in time to each other? Please include the estimated time to prepare the application as well as the estimated time for FINRA to process the application.
43. How long does it typically take to complete the application process with a national securities exchange? Please include the estimated time to prepare the application as well as the estimated time for an exchange to process the application.
44. To the extent a firm intends to rely on one or more of the exemptions in the amended rule, how long would it take such firm to make the required systems changes to comply? Are there other steps that would need to be taken to achieve compliance? If so, what is the estimated time to accomplish those

steps? How long would it take a firm to establish the policies and procedures that would be necessary to rely on the stock-option order exemption?

45. To the extent a firm intends to adjust its business model or organizational structure such that it effects securities transactions only on an exchange of which it is a member, how long would it take such firm to make such an adjustment? What systems or other changes would be required?

V. General Requests for Comments

The Commission seeks comment on all aspects of the proposed amendments to Rule 15b9-1. Commenters should, when possible, provide the Commission with data to support their views. Commenters suggesting alternative approaches should provide comprehensive proposals, including any conditions or limitations that they believe should apply, the reasons for their suggested approaches, and their analysis regarding why their suggested approaches would satisfy the objectives of the proposed amendments.

46. The Commission requests comment generally on whether the proposed amendments to Rule 15b9-1 are appropriate. How, if at all, should the proposed amendments be modified? Should either of the proposed exemptions from Association membership set forth in proposed paragraphs (c)(1) and (c)(2) of the amended rule be eliminated? If so, why? For example, should the Commission maintain the proposed routing exemption, but not maintain the proposed stock-option order exemption? Why or why not? Should the Commission maintain the proposed stock-option order exemption, but not the routing exemption? Why or why not?

47. Should the Commission eliminate Rule15b9-1 in its entirety, such that there is no exemption from Section 15(b)(8) of the Act? Broker-dealers would then be statutorily required by Section 15(b)(8) of the Act, without exception, to join an Association if they effect securities transactions otherwise than on an exchange where they are a member. In other words, a broker-dealer that effects transactions in securities otherwise than on an exchange of which it is a member would have to join FINRA even if its transactions result solely from orders that are routed by an exchange of which it is a member to comply with order protection requirements or are solely for the purpose of executing the stock leg of a stock-option order. What would be the benefits or drawbacks of eliminating Rule 15b9-1 in its entirety? Please explain.
48. Should the Commission amend Rule 15b9-1 to capture only those broker-dealers that are exchange members but not FINRA members that account for the high degree of concentration of off-exchange listed equities volume? For example, the Commission estimates that, as of September 2021, 13 of the 47 identified firms that initiated orders in listed equities then accounted for approximately 94% of the off-exchange listed equities transaction volume attributable to the 47 identified firms that month. If so, what methodology should be used to select the most significant firms?
49. Other than the proposed routing exemption and stock-option order exemption set forth in proposed paragraphs (c)(1) and (c)(2) of the amended rule, respectively, are there other exemptions that the Commission should consider?

50. How might dealers that currently rely on Rule 15b9-1's de minimis allowance and proprietary trading exclusion respond to the proposed elimination of these provisions from the amended rule? Might they seek to avoid Association membership in ways other than complying with the exemptions in the amended rule, i.e., are there ways they could avoid Association membership other than by ceasing all off-exchange activity and becoming a member of each exchange on which the firm effects securities transactions, or limiting the firm's securities transactions elsewhere than an exchange where it is a member such that they comply with the routing exemption or stock-option order exemption? If so, please explain.

51. Reliance on Rule 15b9-1 is currently self-effecting (i.e., the rule does not require the reporting of such reliance to the Commission or any other regulatory authority). In lieu of the proposed amendments, should the Commission require broker-dealers relying on Rule 15b9-1 to report such reliance to the Commission or to the exchange of which the broker-dealer is a member? How frequently should such reporting occur? If so, what form should such reporting take and what information should be provided to the Commission or the exchange of which the broker-dealer is a member? For example, should a broker-dealer be required to report in writing to its member exchange and/or the Commission whether it is relying on Rule 15b9-1, and should information such as transactional volume be provided, or information on the type or categories of securities traded? If not, why not and what alternative means could be used to collect data about reliance on Rule 15b9-1?

52. If the Commission were to eliminate Rule 15b9-1 altogether, how many broker-dealers would: (i) effect securities transactions only on national securities exchanges of which they are already member; (ii) become members of additional national securities exchanges such that they are not required to join an Association; and/or (iii) become members of an Association?
53. Would the proposed amendments have an effect on market liquidity? If so, please estimate that effect. Would there be any deleterious impacts on market quality? Would there be positive impacts on market liquidity or market quality more broadly?
54. Should the Commission allow broker-dealers that are a member of an exchange and conduct off-exchange trading activity to remain exempt from membership in an Association? If so, why? Should the level of off-exchange activity affect the ability of a firm to be exempt from Association membership? Why or why not?
55. Does the CAT plan mitigate the need for the proposed amendments to Rule 15b9-1? If so, how? Would it be appropriate and feasible to modify CAT reporting to accomplish any of the goals of amended Rule 15b9-1?
56. Do existing 17d-2 plans and RSAs among SROs mitigate the need for the proposed amendments to Rule 15b9-1? If so, how? Do commenters agree that RSAs are subject to change and may not in the future provide the stability of FINRA oversight? How frequently are RSAs typically renegotiated?

57. Is Association membership an efficient or effective approach for the regulation of firms that trade across multiple exchanges but do not trade off-exchange? Are there more effective alternatives?

58. Under the proposed amendments to Rule 15b9-1, a broker-dealer that does not effect securities transactions off an exchange, but currently effects securities transactions on an exchange of which it is not a member, would be required either to join an Association or become a member of each exchange where it effects securities transactions, unless its exchange trading is covered by an exemption in the proposed amended rule. Should the proposed amendments be revised to provide an exemption from Section 15(b)(8) of the Act to permit such a firm, with no off-exchange trading, to remain exempt from membership in an Association and continue trading on exchanges of which it is not a member even if that trading activity would not satisfy one of the proposed exemptions in the amended rule? Should any such approach be based on certain conditions being met, such as any exchange of which the firm is a member entering into appropriate contractual or self-regulatory responsibility sharing arrangements such that an exchange SRO is in a position to effectively surveil all of the trading activities of that firm?

59. If the proposed rule amendments are adopted, proprietary trading broker-dealers that are not currently FINRA members may join FINRA. Would this affect FINRA's governance or its performance of its regulatory or supervisory functions?

60. Are there other changes the Commission should make to Rule 15b9-1? If so, why? What specifically should be changed and how? How would any such changes better achieve the stated goals of the proposal?

VI. Economic Analysis

The Commission is proposing to amend Rule 15b9-1 to re-align it with today's market so that the regulatory scheme more appropriately effectuates Exchange Act principles regarding complementary exchange SRO and Association oversight. Currently, a broker or dealer may engage in unlimited proprietary trading in the off-exchange market without becoming a member of an Association, so long as its proprietary trading activity is conducted with or through another registered broker or dealer.

However, the Exchange Act's statutory framework places SRO oversight responsibility with an Association for trading that occurs elsewhere than on an exchange to which a broker or dealer belongs as a member.[199] Currently, nearly all equity activity of non-FINRA member broker-dealers is surveilled by FINRA through the extensive use of RSAs. However, RSAs are voluntary, privately negotiated agreements that can expire or be terminated, and accordingly, these agreements do not provide the consistent and stable oversight that direct Association oversight of such trading activity does.[200] For example, of the current FINRA RSA contracts: six RSA contracts expire by the end of 2023, two RSA contracts expire by the end of 2024, and

199 See Section I, supra.

200 See Section I, supra.

three RSA contracts expire by the end of 2025 unless extended or terminated early.[201] The amendments would provide consistency and stability of oversight in the future.

In the case of U.S. Treasury securities and other fixed income securities (other than municipal bonds)[202] that trade off-exchange, surveillance relies on TRACE data which is collected by FINRA from its members. Some dealer firms that are not FINRA members are significantly involved in trading U.S. Treasury securities[203] proprietarily but are not required to report these transactions because they are not FINRA members. Consequently, trades that do not occur on an ATS that are between two non-FINRA member broker-dealers are not reported to TRACE at all and trades that occur on an ATS that is not a covered ATS do not specifically identify the non-FINRA member in the information reported by the ATS to TRACE.[204]

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201 Based on information provided by FINRA.

202 Municipal bond trades are reported to the MSRB but not TRACE, so the Commission does not expect the proposed amendments to affect the data collected on municipal bonds. Off-exchange trading of both listed and unlisted equities by non-FINRA member broker-dealers is already reported to CAT.

203 The Commission can observe and quantify some of this activity through the reporting of U.S. Treasury securities on covered ATSs as discussed in Section II.B. See supra note 96. Because there is no analogous reporting regime in other fixed income securities, the Commission cannot similarly describe non-member broker-dealer activity in these other securities, but it is likely that non-member broker-dealers also trade fixed-income securities other than U.S. Treasury securities and these transactions are also not reported to TRACE. This Economic Analysis focuses on the effects on equities, options, and U.S. Treasury securities markets. To the extent that non-FINRA member broker-dealers do trade in additional asset classes, the Commission believes that the economic impacts discussed herein would also apply. In particular, if a non-FINRA member broker-dealer does trade in an asset class which requires reporting to FINRA, the proposal would improve transparency for these securities, which would enhance the regulatory oversight of such activity.

204 See Section II.B, supra. The Commission preliminarily believes this is a small fraction of U.S. Treasury securities trading. In April 2022, the Commission estimates that non-FINRA member firms' U.S. Treasury securities transactions executed on covered ATSs accounted for 2.5% of total U.S. Treasury securities transaction volume reported to

The Exchange Act presents exchange SROs and Associations as complements, providing for member-based supervision both on and off-exchange. The proposed amendments would rescind the de minimis allowance and proprietary trading exclusion so that the regulatory scheme more appropriately effectuates Exchange Act principles regarding complementary exchange SRO and Association oversight in today's market.[205] For firms currently relying on the exemption that would be required to register with FINRA under the proposed amendments, joining FINRA will expose them to additional costs that they previously did not incur.[206] While reliance on the exemption may be cost-efficient for these firms, it introduces inefficiencies for exchange SROs, FINRA, and regulatory oversight more generally. FINRA, the sole Association, has a rulebook, surveillance infrastructure, and supervisory expertise that is targeted to off-exchange trading of both listed and unlisted securities. Without an RSA, when FINRA detects potentially violative behavior by a non-FINRA member firm, it can and does refer such cases to other SROs or the SEC. However, it lacks certain investigative tools, which could help it further investigate potentially violative behavior before making such referrals. As such, FINRA referrals could be premature. In addition, RSAs with FINRA are privately negotiated contracts that can differ from exchange to exchange and the administrative and operational burdens create

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TRACE that month. See supra note 94. The unreported trades involving only non-FINRA member firms that are not executed on covered ATSs might be similar but could be a lower fraction of the total U.S. Treasury securities volume. The Commission believes that all fixed income trading should be reported. The Commission also believes that firms that can observe other firms' trades and not report their own trades may have a competitive advantage, the cost of which is borne by the investing public through reduced price discovery.

205 See Section II.B, supra.

206 FINRA member firms that compete with these firms may be at a cost disadvantage due to this fee disparity.

inefficiencies in investigating potential non-compliance. As such, oversight through an RSA is not equivalent to direct oversight by FINRA of its members. The Commission believes that, particularly in the case of fixed income trading, FINRA is the SRO best positioned to efficiently investigate such instances because of its TRACE data collection and expertise in such trading, and such a role is consistent with the SRO structure mandated by the Exchange Act.

The Commission discusses below a number of economic effects that are likely to result from the proposed amendments.[207] As discussed in detail below, the effects are quantified to the extent practicable. Although the Commission is providing estimates of direct compliance costs where possible, the Commission also anticipates that brokers and dealers affected by the amendments, as well as competitors of those broker and dealers, may modify their business practices regarding the provision of liquidity in both off-exchange markets and on exchanges. Consequently, much of the discussion below is qualitative in nature, but where possible, the Commission has provided quantified estimates.[208] To the extent that non-FINRA member firms change their business practices, by reducing or eliminating their off-exchange trading activity, the proposal may impact competition and harm liquidity, particularly in the off-exchange market.

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207 The Commission is sensitive to the economic effects of its rule, including the costs and benefits and effects on efficiency, competition, and capital formation. Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking pursuant to the Exchange Act, to consider or determine whether an action is necessary or appropriate in the public interest, and to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. See 15 U.S.C. 78c(f). In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the effect such rules would have on competition. See 15 U.S.C. 78w(a)(2). Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

208 See infra Section VI.C. for further discussion of the difficulties in estimating market quality effects likely to result from the amendments.

The proposal would increase costs for non-FINRA member firms that will have to register with FINRA, which may result in decreased liquidity from their orders. Additionally, the amendments to Rule 15b9-1 may create incentives for non-FINRA member firms that are impacted by the amendments to form a new Association.

A. Baseline

1. Regulatory Structure and Activity Levels of Non-FINRA Member Firms

The Exchange Act governs the way in which the U.S. securities markets and its brokers and dealers operate. Section 3(a)(4)(A) of the Act generally defines a "broker" broadly as "any person engaged in the business of effecting transactions in securities for the account of others."[209] In addition, Section 3(a)(5)(A) of the Act generally defines a "dealer" as "any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise."[210]

Generally, any broker-dealer that wants to interact directly on a securities exchange must register with the Commission as a broker-dealer before applying to gain direct access to the exchange.[211] There is diversity in the size and business activities of brokers and dealers. Carrying brokers and dealers hold customer funds and securities; some of these are also clearing brokers and dealers that handle the clearance and settlement aspects of customer trades, including record-keeping activities and preparing trade confirmations.[212] However, of 3,528

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209 15 U.S.C. 78c(a)(4)(A).

210 15 U.S.C. 78c(5)(A).

211 A firm that wishes to transact business upon an exchange without becoming a broker or dealer can do so by engaging a broker-dealer that is a member of that exchange to provide market access and settlement services.

212 Based on December 2021 FOCUS data.

registered brokers and dealers, only 156 were classified as carrying or clearing brokers and dealers during the fourth quarter of 2021. Thus, the majority of brokers and dealers engage in a wide range of other activities, which may or may not include handling customer accounts. These other activities include intermediating between customers and carrying/clearing brokers; dealing in government bonds; private placement of securities; effecting transactions in mutual funds that involve transferring funds directly to the issuer; writing options; acting as a broker solely on an exchange; and providing liquidity to securities markets, which includes, but is not limited to, the activities of registered market makers.

Most brokers and dealers are small, with 66% of brokers and dealers employing 15 or fewer associated persons and only 10% of brokers and dealers employing over 100 associated persons.[213] Further, while there are many registered brokers and dealers, a small minority of brokers and dealers controls the majority of broker and dealer capital and each play a significant role in the allocation of capital to liquidity provision.[214]

The Commission has identified 65 firms that, as of April 2022, were Commission registered broker-dealers and exchange members, but not members of FINRA, that may be required to either join an Association or change their trading practices under the proposed amendments.[215] To the extent that the definitions of "dealer" and "government securities dealer"

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213 Based on December 2021 Annual FOCUS data filings. See also supra note 136.

214 See infra Section IX.

215 Historically, floor brokers had only incidental trading on exchanges of which they were not members, and limited off-exchange trading activity. The background and history of Rule 15b9-1 are discussed in Section I.

might change, the number of affected firms could increase.[216] Because of Rule 15b9-1's exclusion of proprietary trading, a dealer that does not carry customer accounts may not be required to join an Association as long as they are a member of an exchange SRO, even when that dealer has substantial off-exchange trading activity.

In September 2021, there were 66 registered broker-dealers that were exchange members but not FINRA members.[217] The Commission is aware that some non-FINRA member firms trade U.S. Treasury securities. Covered ATSs report the U.S. Treasury securities trading activity of non-FINRA-member firms to TRACE. The Commission estimates that, in 2021, four of the 66 non-FINRA member firms had $7 trillion in U.S. Treasury securities volume reported to TRACE by covered ATSs. This accounts for approximately 2% of U.S. Treasury volume as reported to TRACE throughout the year. In April 2022, there were three non-FINRA member firms with approximately $700 billion in U.S. Treasury securities volume executed on covered ATSs or approximately 2.5% of total U.S. Treasury securities transaction volume reported to TRACE that month.

FINRA members are required to report transactions in TRACE-eligible securities. Market participants can gain real-time access to TRACE through market vendors, for most TRACE-eligible securities, with a few exceptions including U.S. Treasury securities.[218]

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216 See supra note 155 and accompanying text.

217 See supra note 74.

218 See FINRA.org, TRACE at 20 – Reflecting on Advances in Transparency in Fixed Income, available at https://www.finra.org/media-center/blog/trace-at-20-reflecting-advances-transparency-fixed-income (last visited July 22, 2022). See also FINRA Rule 6750(c).

However, FINRA does make public aggregate U.S. Treasury securities data on a weekly basis.[219] Non-FINRA member firms are not required to report their trading activity to TRACE. With respect to trading activity in U.S. Treasury securities markets on a covered ATS, non-FINRA member counterparties are identified in TRACE.[220] With respect to trading activity in other TRACE-eligible securities, non-FINRA member counterparties are not identified in TRACE. Therefore, the Commission is unable to estimate the level of trading activity of non-FINRA member firms for other fixed income securities, and cannot reasonably assume either significant or insignificant unreported volume. However, based on the non-FINRA member firms' activity in U.S. Treasury securities markets, some non-FINRA member firms are likely to be active in other fixed income markets as well.

In September 2021, of the 66 non-FINRA member firms, 47 initiated equity orders that were not executed on an exchange, accounting for $789 billion (approximately 9.8%) in off-exchange traded dollar volume in listed equities.[221] In April 2022, of the 65 non-FINRA member firms, 43 initiated equity orders that were not executed on an exchange, accounting for $441 billion (approximately 4.6%) in off-exchange traded dollar volume in listed equities.

There is significant diversity in the business models of non-FINRA member firms. Some non-FINRA member firms may limit their equity trading to a single exchange, while others trade on multiple venues including off-exchange venues such as ATSs. Some firms are significant contributors to both off-exchange and exchange volume. Because CAT requires reporting of all

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219 See supra note 45 and accompanying text.

220 See supra note 112 and accompanying text.

221 See supra Section II.B for further discussion of trading activities of non-FINRA member firms.

NMS stock trades, including off-exchange trades, FINRA and the Commission are able to quantify the aggregate off-exchange activity of non-FINRA member firms.

Off-exchange equity trading occurs across many trading venues. In quarter 3 of 2021, 32 ATSs actively traded NMS stocks, comprising 9.6% of NMS stock share volume. Furthermore, 187 named[222] broker-dealers transacted a further 33% of NMS stock share volume off-exchange without the involvement of an ATS. Although many market participants provide liquidity within this market, non-FINRA member firms are particularly active within ATSs.[223] Although non-FINRA member firms may trade in the non-ATS segment of the off-exchange market, the Commission believes they rarely act as liquidity suppliers outside of ATSs because they do not carry customer accounts that might generate orders they could fill from inventory.

While some non-FINRA member firms trade actively off-exchange, some of these firms also supply and demand liquidity actively on multiple equity and options exchanges. Table 1 below shows the executed dollar volume in listed equities by trading venue type during September 2021 and April 2022 for the non-FINRA member firms. Table 2 below shows the executed dollar volume, number of trades, and number of contracts in options during September 2021 and April 2022 for the non-FINRA member firms.

Table 1: Non-FINRA Members NMS Equity Trading Volume by Venue Type

	Traded Dollar Volume			
	Sept 2021		**April 2022**	
	Billions ($)	% of total	Billions ($)	% of total
I. All Non-FINRA Member Firms[1]				
Trading Venue:				

222 ATSs often report the MPID of counterparties that are not FINRA members, allowing their activity to be partially identified in CAT data.

223 See Table 1 for information on trading activities on ATSs.

Off-Exchange: ATS	661.50	11.9	374.43	9.8
Off-Exchange: Non-ATS	127.50	2.3	66.57	1.7
On-Exchange: Exchange Member[2]	4,190.57	75.2	2,904.01	76.0
On-Exchange: Cross-Exchange[3]	592.29	10.6	475.30	12.4
Total	5,571.87	100.0	3,820.32	100.0
II. Largest Non-FINRA Member Firms[4]				
Trading Venue:				
Off-Exchange: ATS	629.41	12.9	345.56	10.9
Off-Exchange: Non-ATS	114.59	2.3	58.19	1.8
On-Exchange: Exchange Member[2]	3,622.30	74.1	2,384.36	75.1
On-Exchange: Cross-Exchange[3]	520.97	10.7	388.48	12.2
Total	4,887.27	100.0	3,176.59	100.0

Data Source: CAT

1. Non-FINRA Member firms that initiated orders that were executed either on or off-exchange. There were 47 firms in September 2021 and 43 firms in April 2022.

2. Exchange Member refers to trades executed on an exchange where the Non-FINRA member is a registered member.

3. Cross-Exchange refers to trades executed on an exchange where the Non-FINRA member is not a registered member.

4. The largest Non-FINRA member firms ranked by off-exchange traded dollar volume. There were 13 firms in September 2021 and 12 firms in April 2022.

Table 2: Non-FINRA Members Options Trading Volume by Venue Type

Panel A: Option Dollar Volume

	Traded Dollar Volume			
	Sept 2021		**April 2022**	
	Millions ($)	% of total	Millions ($)	% of total
I. All Non-FINRA Member Firms[1]				
Trading Venue:				
On-Exchange: Exchange Member[2]	650.75	94.6	713.10	92.9
On-Exchange: Cross-Exchange[3]	37.09	5.4	54.45	7.1
Total	687.84	100.0	767.54	100.0
II. Largest Non-FINRA Member Firms[4]				
Trading Venue:				
On-Exchange: Exchange Member[2]	493.09	94.1	645.48	92.6
On-Exchange: Cross-Exchange[3]	31.05	5.9	51.37	7.4
Total	524.14	100.0	696.85	100.0

Panel B: Number of Trades

	Trades			
	Sept 2021		April 2022	
	Millions	% of total	Millions	% of total
I. All Non-FINRA Member Firms[1]				
Trading Venue:				
On-Exchange: Exchange Member[2]	28.33	96.1	23.04	93.2
On-Exchange: Cross-Exchange[3]	1.14	3.9	1.67	6.8
Total	29.47	100.0	24.71	100.0
II. Largest Non-FINRA Member Firms[4]				
Trading Venue:				
On-Exchange: Exchange Member[2]	20.72	95.9	20.96	93.4
On-Exchange: Cross-Exchange[3]	0.89	4.1	1.49	6.6
Total	21.61	100.0	22.44	100.0

Panel C: Number of Contracts

	Contracts			
	Sept 2021		April 2022	
	Millions	% of total	Millions	% of total
I. All Non-FINRA Member Firms[1]				
Trading Venue:				
On-Exchange: Exchange Member[2]	197.36	95.2	185.65	94.4
On-Exchange: Cross-Exchange[3]	9.97	4.8	10.93	5.6
Total	207.33	100.0	196.58	100.0
II. Largest Non-FINRA Member Firms[4]				
Trading Venue:				
On-Exchange: Exchange Member[2]	138.33	94.8	167.37	94.6
On-Exchange: Cross-Exchange[3]	7.65	5.2	9.57	5.4
Total	145.98	100.0	176.94	100.0

Data Source: CAT

1. Non-FINRA Member firms that initiated options orders that were executed. There were 42 firms in September 2021 and 35 firms in April 2022.
2. Exchange Member refers to trades executed on an exchange where the Non-FINRA member is a registered member.
3. Cross-Exchange refers to trades executed on an exchange where the Non-FINRA member is not registered member.
4. The largest non-FINRA member firms ranked by equity off-exchange traded dollar volume. Nine of the largest 13 firms in September 2021 and nine of the largest 12 firms in April 2022 initiated options orders that were executed.

Table 1 shows that the majority of non-FINRA member firms executed listed equity orders (approximately 75%) on exchanges where the firm was a registered member. However, they also transacted on exchanges where the firm was not a member in addition to trading off-exchange. Table 2 shows the number of non-FINRA member firms that also executed trades in the options market and the total dollar, trades, and contract volume. In September 2021, forty-two non-FINRA member firms and nine of the 13 largest firms executed trades on options exchanges. Eight of the nine largest firms executed trades on seven or more options exchanges. In April 2022, 35 non-FINRA member firms and nine of the 12 largest firms executed trades on options exchanges.

2. Current Market Oversight

The surveillance and regulation of each broker or dealer is partially dependent upon its individual SRO membership status. Each SRO is required to examine for and enforce compliance by its members and associated persons with the Exchange Act, the rules and regulations thereunder, and the SRO's own rules, including, for exchange SROs, the rules on the trading that occurs on the exchange it oversees. Because of this, SROs that oversee an exchange generally possess expertise in regulating members who specialize in trading on their exchange and in using the order types that may be unique or specialized within the exchange. This expertise complements the expertise of an Association in supervising cross-exchange and off-exchange trading activity.[224]

While all exchanges are SROs and have access to CAT data covering trading activity by their members both on and off exchanges, currently nearly all equity activity and much options

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224 See supra Section II, discussing the requirement for SROs to examine for and enforce compliance with the Exchange Act, and the rules and regulations thereunder.

activity of non-FINRA member broker-dealers is surveilled by FINRA through the RSAs with exchange SROs. However, RSAs are voluntary, privately negotiated agreements that can expire or be terminated, and accordingly, these agreements may not in the future provide the consistency and stability of direct FINRA oversight. U.S. Treasury security trading and other fixed income trading,[225] however, is not covered by CAT; instead transactions in these securities are only reported to FINRA's TRACE database when there is a FINRA member that is party to the trade or the trade occurs on an ATS because such reporting results from a FINRA rule.[226] Where no FINRA member is party to the transaction, and the transaction does not take place on an ATS, it goes unreported to TRACE.

Some exchanges serve as DEA for certain of their members.[227] Financial and operational requirements share many commonalities across SROs, such as net capital requirements and books and records requirements. Because many brokers and dealers are members of multiple SROs with similar requirements, one SRO is appointed as the broker's or dealer's DEA to examine common members for compliance with the financial responsibility requirements imposed by the Act, or by Commission or SRO rules.[228] The exchange serving as DEA has

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225 Municipal bond trades are not reported to TRACE.

226 All ATSs are operated by FINRA member firms.

227 See supra note 30.

228 See supra note 30. See 17 CFR 240.17d-1. FINRA serves as the DEA for the majority of member firms; there are exceptions, mostly involving firms that have specialized business models that focus on a particular exchange that is judged to be best situated to supervise the member firm's activity. These firms are, however, subject to the same supervision of their trading activity as other member firms for whom FINRA does act as DEA, and the DEA stipulates which SRO has responsibility to supervise the firm but does not allow for less supervision. Under the amendments, non-FINRA member firms that join FINRA may or may not be assigned to FINRA for DEA supervision.

regulatory responsibility for their common members' compliance with the applicable financial responsibility rules. However, the non-DEA exchange maintains responsibility for compliance with its own rules and provisions of the federal securities laws governing matters other than financial responsibility, including sales practices and trading activities and practices, although the SROs may also allocate other regulatory responsibilities.

All registered brokers and dealers are required to join an Association unless they effect transactions in securities solely on a national securities exchange of which they are a member or are exempt from the membership requirement pursuant to Rule 15b9-1. The vast majority of brokers and dealers join an Association and, because FINRA is the only Association, brokers and dealers are subject to relatively uniform regulatory requirements and levels of surveillance and supervision. Supervision by FINRA, which is currently the only Association, covers a market that is fragmented across many trading venues, including the more opaque off-exchange market.[229] Additionally, FINRA oversees its member's activity in equity, fixed income, and derivative markets and thus has the ability to supervise asset classes that may be outside the expertise of certain exchange SROs.

The existing Association, FINRA, serves crucial functions in the current regulatory structure.[230] The Exchange Act's statutory framework places responsibility for off-exchange

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229 Comprehensive reporting requirements for all member firms that trade off-exchange give FINRA information on market activity levels and market conditions off-exchange. Because most off-exchange venues do not publicly disseminate information on the liquidity available in their systems, comprehensive information from all participants through CAT allows FINRA to analyze and surveil the off-exchange market. See supra notes 40-43.

230 See supra Section II for further discussion of the role of Associations in market oversight.

trading with an Association.[231] Pursuant to that, FINRA has established a regulatory regime for FINRA members, including FINRA members conducting business in the off-exchange market for various asset classes, and developed surveillance technology and specialized regulatory personnel to provide surveillance, supervision, and enforcement of activity occurring off-exchange. Consequently, the current regulatory structure achieves cross-market and off-exchange supervision through the surveillance actions of FINRA of the market generally and its examination of its members.

Additionally, despite the fact that FINRA does not have the authority to monitor non-FINRA member firms that are not covered by RSA or 17d-2 plans that include these services, the Commission understands that FINRA operates a cross-market regulatory program that covers 100% of equity trades and 45% of option trading.[232] FINRA does not have direct membership-based jurisdiction over non-FINRA member firms. However, FINRA refers cases for enforcement to the SRO with jurisdiction or to the Commission. If FINRA is performing regulatory services for an exchange SRO pursuant to an RSA, FINRA may, on behalf of the exchange SRO, investigate and bring an enforcement action against an exchange SRO member that is not a FINRA member, assuming that those services are covered by the RSA.[233] However, each RSA is independently negotiated and thus they are not standardized. Therefore, FINRA's ability to provide oversight can vary based on the nature of its regulatory services agreement with the exchange SRO. Additionally, the ultimate responsibility for that regulatory oversight

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231 See supra note 8.

232 See Cross-Market Regulatory Coordination Staff Paper, supra note 31.

233 In most but not all cases, FINRA is empowered to take such actions.

still rests with the exchange SRO, not with FINRA.[234] SROs may also use 17d-2 plans which allow SROs with common members to designate a DEA to examine common members. However, 17d-2 plans do not confer jurisdiction as they apply only to common firms of which each SRO would already have jurisdiction.[235] Exchange SROs may not be efficient at monitoring off-exchange activity. Because of the historical reliance on FINRA as the examination and surveillance authority over off-exchange trading, exchanges have limited resources and may have incentives to prioritize the following up on potential violations of on-exchange activity over off-exchange activity. However, such incentives are likely curtailed by the exchange SROs' legal responsibilities under the Exchange Act to examine and enforce compliance by their members with the Exchange Act, the rules thereunder, and the SRO's own rules and the reputational damage they may experience if they do not.

Currently, some non-FINRA member firms transact heavily in the course of normal business activities within venues regulated by SROs of which they are not members. This activity is not limited to equities; non-FINRA member firms play a large role in U.S. Treasury securities markets as well.[236] In 2021, there were four non-FINRA member firms that together traded more than $7 trillion in U.S. Treasury securities volume on covered ATSs, which accounted for 2% of total U.S. Treasury securities trading volume[237] reported to TRACE. In

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234 See supra note 109.

235 See supra note 30.

236 See supra Section VI.A.1 and accompanying text for more information on trading in U.S. Treasury securities markets.

237 The Commission estimated that in July 2021 there were 626 total firms that traded U.S. Treasury securities. See Table 1 of Securities Exchange Act Release No. 94524 (March 28, 2022), 87 FR 23054, 23081 (April 18, 2022).

April 2022, the Commission estimates that three non-FINRA member firms totaled $700 billion in U.S. Treasury securities volume executed on covered ATSs, which accounted for 2.5% of total U.S. Treasury securities transaction volume reported to TRACE that month.

This is very different from when Rule 15b9-1 was first adopted. The Act provides for regulation of exchange trading by the exchanges themselves; it further generally provides for supervision of off-exchange trading by an Association.[238]

SRO rules require their members to report CAT data daily.[239] This data records the origination, receipt, execution, routing, modification, or cancellation of every order a member firm handles for NMS stocks and options, with the exception of primary market transactions.

Because non-FINRA member firms are not required to join an Association if they qualify for an exemption, they are not required to pay the costs of Association membership, which could be significant, especially for non-FINRA member firms with substantial trading activity. FINRA members currently pay fees associated with FINRA membership including the annual Gross Income Assessment (GIA), the annual personnel assessment; and the TAF and Section 3 fees.[240] FINRA members pay the TAF for all sales transactions of covered securities that are not performed in the firm's capacity as a registered specialist or market maker upon an exchange.[241]

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238 See supra note 8.

239 See generally FINRA Rule 6800 Series and 17 CFR 242.613.

240 See infra Section VI.C.2.b. for more information on the fees.

241 Covered securities include all equity, options and U.S. Treasury securities. For an explanation of what is included and exempt from the TAF, see FINRA Rules and Guidance, available at https://www.finra.org/rules-guidance/rulebooks/corporate-organization/section-1-member-regulatory-fees. After the 2015 Proposal, FINRA proposed an exemption that "would exempt from the TAF transactions executed by proprietary trading firms on an exchange of which the firm is a member (including non-market maker trades)." See FINRA Regulatory Notice 15-13, Trading Activity Fee (May

FINRA members also must pay Transaction Reporting Fees for TRACE reportable securities, with the exception of U.S. Treasury securities.

The FINRA Section 3 fee is the second of two primary FINRA fees (the other being TAF) that are assessed upon each off-exchange sale by or through a FINRA member. Under Section 31 of the Act,[242] SROs must pay transaction fees based on the volume of their covered sales. These fees are designed to offset the costs of regulation incurred by the government—including the Commission—for supervising and regulating the securities markets and securities professionals. FINRA obtains money to pay its Section 31 fees from its membership, in accordance with Section 3 of Schedule A to the FINRA By-Laws. FINRA assesses these Section 3 fees on the sell side of each off-exchange trade, when possible. When the sell side of an off-exchange transaction is a non-FINRA member firm and the seller engages the services of a clearing broker that is a member firm, FINRA can assess the Section 3 fee against the member firm clearing broker.[243] When the seller is a non-FINRA member firm that self-clears, FINRA has no authority to assess the Section 3 fee against the seller. In such case, FINRA would seek to assess the fee against the buyer, if the buyer includes a member firm counterparty or a member firm acting as clearing broker for a non-FINRA member firm buy side counterparty. Firms that carry customer accounts are required to be a member of an Association and thus these firms bear

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2015), at 3, available at http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-13.pdf. FINRA stated that the proposed exemption "would result in a lower TAF for trades executed on an exchange for which the proprietary trading firm is a member than a trade executed elsewhere." Id. at 5. The proposed exemption to the TAF is not effective.

242 15 U.S.C. 78ee.

243 The seller's clearing broker may pass that fee on to the non-FINRA member firm.

the aforementioned fees. These costs may be passed on in part or in whole to the investing public or the non-FINRA member counterparty.

3. Current Competition to Provide Liquidity

The market for liquidity provision on equity exchanges is competitive. In September 2021 across all exchanges, each equity security had between 1 to 47 registered market makers providing liquidity. The median equity security had 3 registered market makers, and 75% of securities had 2 or more registered market makers. Twenty-five percent of equity securities had 6 or more registered market makers. Additionally, while the number of market makers provides a good indication as to the number of firms in the business of providing liquidity, it does not necessarily indicate whether each market maker is an active competitor. However, the Commission believes that many market makers actively compete to provide liquidity.

As stated above, non-FINRA member firms do not have the same regulatory costs as FINRA member firms, which may give non-FINRA member firms a competitive advantage in providing liquidity. As such, non-FINRA member firms may be able to provide liquidity at a lower cost than FINRA member firms given that non-FINRA member firms have a lower variable cost, all else equal, for trading compared to FINRA member firms.

The Commission believes that non-FINRA member firms are active participants in the market to provide liquidity in off-exchange markets. The Commission estimates that non-FINRA member firms account for between 4.6% and 9.8% of off-exchange dollar volume in equities. Additionally, nearly 10% of all non-FINRA member equity trading activity occurs in off-exchange markets. In U.S. Treasury securities markets, non-FINRA member firms trading activity that is reported by covered ATSs account for 2.5% of all transaction volume.

B. Effects on Efficiency, Competition, and Capital Formation

In addition to the specific, individual benefits and costs discussed below, the Commission expects the amendments may have varying effects on efficiency, competition, and capital formation. These effects are described in this section. The proposal may result in improved efficiency of capital allocation. To the extent that liquidity provision changes as a result of the proposal, market efficiency might be impacted. Additionally, the proposal would have mixed effects on competition to provide liquidity, as current non-FINRA member firms may be less likely to provide liquidity but current FINRA members may be more likely to provide liquidity. The Commission believes that the amendments would not likely have a meaningful effect on capital formation.

1. Firm Response and Effect on Market Activity and Efficiency

Although non-FINRA member firms could seek to comply with the amendments in multiple ways, each route could involve changes to firms' business models. Some non-FINRA member firms may limit their trading to exchanges of which they are members, and the Commission believes that some may not trade off-exchange other than to comply with Rule 611 of Regulation NMS or the Options Linkage Plan,[244] or to execute the stock leg of a stock-option order.[245] These firms would remain exempt from the requirement to become a member of an Association, if they comply with Section 15(b)(8) of the Act or the Rule as amended.[246] Other firms would no longer be exempt, and would need to take action to comply with the amended rule. Under the amended Rule, a non-FINRA member firm that trades equities, options or fixed

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244 See supra Section III.B.1.

245 See supra Section III.B.2.

246 Changes to the exclusion are discussed in Section III.B, supra.

income securities off-exchange, or upon exchanges of which it is not a member, can comply in four ways. The first option would be to join an Association. The second option would be to join all exchanges upon which the non-FINRA member firm wishes to trade, and to cease any off-exchange trading, other than off-exchange trading consistent with the routing exemption and stock-option order exemption. Third, a non-FINRA member firm could comply by trading solely upon those exchanges of which it is already a member, consistent with the statutory exemption in Section 15(b)(8).[247] Finally, a non-FINRA member firm could cease trading securities.

The changes non-FINRA member firms make to their business model to comply with the amendments may affect competition in the equity and U.S. Treasury securities markets, particularly for off-exchange liquidity provision. Non-FINRA member firms may be less willing to compete to provide liquidity off-exchange, decreasing off-exchange liquidity. For example, non-FINRA member firms may choose to cease their off-exchange activity rather than join an Association—although it is likely that firms that trade heavily in the off-exchange market may find it more costly to cease their off-exchange activity than to join an Association.[248] In addition, non-FINRA member firms that choose to join an Association may reduce their off-

247 15 U.S.C. 78o(b)(8).

248 Firms with very low ATS activity are unlikely to directly connect to an ATS, instead accessing ATSs through a member firm. For firms with very limited off-exchange activity, ceasing off-exchange activity is likely to be less costly than joining an Association. The costs of joining FINRA are discussed in detail in infra Section VI.C.2; for firms with very limited off-exchange activity, it is unlikely that the profits generated from this activity would offset FINRA membership costs. However, for firms that generate profits from off-exchange activities that exceed FINRA membership costs, it may be less costly to join FINRA than to cease their off-exchange activity.

exchange trading because joining an Association would increase variable costs to trade in the off-exchange market, as these trades would incur TAF and possibly additional Section 3 fees, although some Section 3 fees may already be passed on from FINRA member firms to non-FINRA member firms.[249] An increase in cost would reduce the profitability of off-exchange trading and thus potentially reduce off-exchange trading. This sentiment was echoed by one commenter who stated that FINRA registration "would greatly impede" the entry of high frequency proprietary traders to the market.[250] While the Commission agrees that FINRA membership could act as a deterrent to new high frequency trading firms entering the marketplace as broker-dealers, the Commission also believes that access to our capital markets generally requires a certain level of oversight. The Commission believes that the proposal is consistent with the Exchange Act's statutory framework for complementary exchange SRO and Association oversight of broker-dealer trading activity and thus to the extent such firms are

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249 After the 2015 proposal, FINRA considered reevaluating the structure of the TAF to assure that it appropriately considered the business model of certain non-FINRA member firms that might have joined FINRA as a result of the proposed amendments. See supra note 153. The Commission's analysis of TAF is based on current TAF structure as outlined in the FINRA By-Laws, Schedule A. TAF and Section 3 fees are discussed further in Section VI.C.2.b, infra. Firms would also face additional fixed costs both to establish and maintain Association membership; those costs are discussed in Section VI.C.2, infra.

250 See Letter from Michelle Pav (April 16, 2015) ("Pav Letter") at 5. The commenter is concerned with how the duties of best execution and general suitability would apply to proprietary trading firms. Id. The commenter also states that the Commission "clearly does not understand" high frequency trading and FINRA does not have "any more insight into what is happening at [high frequency trading] firms than the SEC." Id. at 2. Some proprietary trading firms are already members of FINRA. As a result, FINRA has experience addressing these issues. Additionally, the rule amendments would provide FINRA and the Commission with greater visibility into the activities of these firms.

required to register with FINRA as a result of the proposal, the costs are justified as part of that regulatory oversight.

The Commission preliminarily believes that requiring membership in an Association, consistent with Rule 15b9-1, could facilitate an appropriate level of oversight. The Commission also recognizes that the loss of liquidity provision in off-exchange trading may impose costs on investors in the form of higher trading costs than they would otherwise realize. These effects may differ across asset classes. In the case of non-FINRA member broker-dealers trading U.S. Treasury securities, costs to join an Association include the costs of establishing TRACE reporting. Depending on the firm's activity level in that market, firms may be more likely to withdraw from that market if their anticipated profit levels from U.S. Treasury securities trading do not justify the additional reporting requirements. The impact on liquidity in U.S. Treasury securities markets is not likely to significantly impact investor costs to trade these securities because U.S. Treasury securities are generally very liquid and competition to provide this liquidity is robust. If some non-FINRA member broker-dealers stop competing in the market to provide this liquidity, other broker-dealers are likely to increase their activity in this market, but the Commission acknowledges that if liquidity decreases, investor costs to trade U.S. Treasury securities could increase.

Additionally, the removal of liquidity from the market could either improve or degrade execution quality on off-exchange markets.[251] Some institutional investors transacting in off-

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[251] Non-FINRA member firms are likely to also reduce their off-exchange trading outside of ATSs, such as on single-dealer platforms. However, non-FINRA member firms can only take (not make) liquidity on these platforms. It is possible that additional off-exchange liquidity may be available outside of ATSs for other market participants as a result of the

exchange markets may seek institutional investor counterparties and avoid transacting with proprietary trading firms. To this extent, the removal of non-FINRA member firm liquidity may be seen as improving liquidity quality within ATSs by some institutional investors.[252] It is also possible that reducing the activity of non-FINRA member firms within ATSs may result in more ATS liquidity, if non-FINRA member firms are acting as net takers of liquidity within these systems.[253] At a minimum, liquidity levels in ATSs may change. In addition, these firms may reduce their off-exchange trading outside of ATSs such as on single-dealer platforms. It is possible that this would result in a transfer of volume from off-exchange venues to exchanges, but it is also possible that overall market trading volume would diminish if decreased volume from off-exchange trading does not migrate to exchanges.

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amendments to Rule 15b9-1 due to a reduction in non-FINRA member firm trading on single-dealer platforms.

252 Industry white papers sometimes discuss the concept of natural counterparties for institutional trades. These papers may explicitly or implicitly identify proprietary automated trading firms as sources of information leakage in dark pools. The Commission understands that some ATSs segment orders so that institutional investors do not trade with PTFs. See e.g., Hitesh Mittal, Are You Playing in a Toxic Dark Pool? A Guide to Preventing Information Leakage, J. Trading, Summer 2008, at 20 (ITG white paper), available at https://jot.pm-research.com/content/3/3/20. Other industry participants describe a more benign role for automated trading firms as liquidity providers in ATSs. See Terry Flanagan, High-Speed Traders Go Dark, Markets Media Commentary (2012), available at https://www.marketsmedia.com/high-speed-traders-go-dark/.

253 There is some evidence that some proprietary trading firms are net takers rather than net suppliers of liquidity in equity markets, although the evidence is not conclusive. Using Nasdaq data from 2008-2010, Carrion estimates that these firms supply liquidity to 41.2% of trading dollar volume and take liquidity in 42.2% of trading dollar volume. See Allen Carrion, Very fast money: High-frequency trading on the NASDAQ, 16 J. Fin. Mkts. 680 (2013). Another study finds that electronic trading firms act as net liquidity suppliers during periods of extreme price movements. See Jonathan Brogaard, Allen Carrion, Thibaut Moyaert, Ryan Riordan, Andriy Shkilko & Konstantin Sokolov, High Frequency Trading and Extreme Price Movements, 128 J. Fin. Econ. 253 (2018).

In response to the 2015 Proposal, several commenters expressed liquidity concerns.[254] One commenter stated that because it would be costly for high frequency trading firms to comply with FINRA regulations, these firms "may not trade as frequently, reducing overall market liquidity."[255] Another commenter stated that proprietary traders provide liquidity and order to the markets and that disadvantaging small proprietary traders may harm the market balance.[256] A third commenter stated that it believes that "unnecessary costs…could hinder competition among liquidity providers, which could negatively impact market liquidity and transaction costs."[257] Finally, one commenter stated that the current FINRA fee structure is imbalanced and risks stifling liquidity in the markets and that there are fewer incentives to provide the same liquidity under FINRA's proposed fee structure as there are under Cboe's regulatory fee structure.[258]

Changes in business models for non-FINRA member firms may affect market quality on exchanges as well. In addition to trading extensively in the off-exchange market, many non-FINRA member firms are among the most active participants on exchanges. Business model changes by these firms may lead to less exchange liquidity for several reasons. First, non-FINRA member firms that choose not to join an Association would no longer be able to rely on the rule and trade indirectly on exchanges of which they are not members, unless they comply

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254 See Pav Letter, Hold Brothers Capital Letter, FIA 1 Letter, and PEAK6 Letter.

255 See Pav Latter at 3.

256 See Hold Brother Capital Letter at 4.

257 See FIA 1 Letter at 3.

258 See PEAK6 Letter at 3-4. This commenter further stated that FINRA fees "may discourage such firms from routing trades to certain markets, thereby disrupting market efficiency." Id. at 4.

with the routing or stock-options order exemptions.[259] Second, non-FINRA member firms that do not join an Association would no longer be able to access off-exchange liquidity to unwind positions acquired on exchanges, which may reduce their willingness to provide liquidity upon exchanges.[260] Third, non-FINRA member firms that choose to join an Association may be subject to additional variable costs (primarily regulatory fees) on their exchange-based trading as well as on their off-exchange trading.[261] These firms may respond by trading less actively on exchanges. Finally, non-FINRA member firms may choose to cease trading rather than join an Association or change their business models. Reduced liquidity upon exchanges can result in higher spreads and increased volatility. Increased spreads on exchanges can lead to increased costs for off-exchange investors as well as investors transacting on exchanges, because most off-exchange transactions (including many retail executions) are derivatively priced with reference to prevailing exchange prices.

The Commission believes that the amendments are not likely to have an economically meaningful effect on direct capital formation, which is the assignment of financial resources to meet the funding requirements of a profitable capital project, in this case, the provision of

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259 Currently, a non-FINRA member firm can indirectly access an exchange of which it is not a member through a firm that is an exchange member. In light of the elimination of the exclusion for proprietary trading, this activity would not be consistent with the amendments, unless the activity complies with the routing or stock-option order exemptions. See supra Sections III.B.1 and III.B.2.

260 These firms could unwind positions on exchanges of which they are a member, but the cost to do so may be higher than if all liquidity, including off-exchange liquidity, were available.

261 It is possible non-FINRA member firms that choose to join an Association may avoid some additional costs by registering as market makers on additional venues, mitigating these charges. Furthermore, they may see a reduction in fees that were formerly paid to their DEA if FINRA assumes that role.

liquidity to financial markets. However, the Commission believes that the changes in allocation of regulatory fees and direct FINRA supervision within the off-exchange market may result in improved efficiency of capital allocation by the financial industry. The proposed amendments may reduce the capital commitment of non-FINRA member firms to liquidity provision. In response, it is possible that current member firms may choose to commit additional capital to liquidity provision when the trading environment has more uniform regulatory requirements. The Commission believes that this may lead to an overall increased commitment of liquidity both to exchanges and the off-exchange market. This increased commitment is likely to have some positive effects on capital market efficiency, such as lower quoted spreads on exchanges. In addition to lowering immediate execution costs on exchanges, lower exchange quoted spreads are likely to reduce transaction costs off-exchange as well, because off-exchange trades are typically priced with reference to quoted exchange prices.

The Commission believes these effects are not likely to be significant because the market to provide liquidity is very competitive. These markets are served by a number of liquidity providers with different business strategies and a strategic change by relatively few competitors is unlikely to disturb liquidity provision overall.

2. Effect on Competition to Provide Liquidity

The proposed amendments may impact competition to provide liquidity by increasing the regulatory cost for current non-FINRA member firms. Currently, non-FINRA member firms do not bear the costs associated with FINRA membership. As such, FINRA member firms bear a number of costs not borne by non-FINRA member firms including a number of regulatory fees

and indirect costs that are assessed or imposed upon member firms.[262] These costs are a part of equity, options and fixed income markets and include direct costs such as trading fees that are either assigned only to member firms, such as TAF, or in the case of Section 3 fees, member firms may be assigned costs that could be assigned to non-FINRA member firms selling securities off-exchange. There are indirect costs of disparate regulatory regimes as well.[263] Under the proposed amendments current non-FINRA members would become subject to the regulatory costs associated with FINRA membership, including TAF, GIA and Section 3 fees. These changes to regulatory costs for non-FINRA member firms may change competitive forces in the market for providing liquidity as the current non-FINRA member broker-dealers have lower regulatory costs, which may make it less costly for non-FINRA member broker-dealers to provide liquidity.[264] However, non-FINRA member firms may already bear a portion, but not all, of these costs as FINRA member firms may pass through their fees to non-FINRA member counterparties. To the extent that non-FINRA member firms do have lower cost for providing

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262 Exchange membership also imposes costs on broker-dealers. Some non-FINRA member firms are members of many exchanges, but not FINRA, while some FINRA-member firms are members of many exchanges as well as FINRA. To the extent that a broker-dealer can avoid FINRA membership, its fee burden may be lower than a broker-dealer that cannot or does not avoid FINRA membership. The Commission preliminarily believes that many non-FINRA member firms would retain their exchange membership if the proposed amendments are adopted in order to maintain the benefits of being a member of the exchange. Therefore, the Commission only considers the additional cost to the firms that are specific to joining FINRA. The Exchange SRO fees are not considered as they are not expected to change. However, a firm may decide to drop their exchange membership on exchanges where they no longer wish to trade after joining FINRA, because maintaining exchange memberships is costly and firms are unlikely to maintain membership in exchanges where they do not plan to have activity. See infra Section VI.C.2, for more information on the fees associated with FINRA membership.

263 See Section VI.C.2.f, infra.

264 See Section VI.B.1, supra for discussion of competitive effects and investor costs.

liquidity than FINRA member firms, the proposed amendments may eliminate such an advantage, and lead to a reduction in liquidity provided by current non-FINRA member firms.

The existing differential regulatory cost burdens of FINRA member firms and non-FINRA member firms may have consequences with respect to market quality both for exchange-based and off-exchange trading. For example, because non-FINRA member firms, all else equal, currently face lower variable costs of trading compared to member firms, non-FINRA member firms may be able to provide liquidity at a lower cost than member firms. It may also reduce direct execution costs (such as quoted and effective spreads) for both exchange and off-exchange trades, the latter of which are normally derivatively priced with reference to prevailing exchange quotes. The differential regulatory burden, however, may also reduce depth at best prices because a member firm may not be able to trade profitably at a price established by a non-FINRA member firm that faces lower regulatory costs. Lower liquidity at best exchange prices implies greater price effect of trades, which may increase trading costs, particularly for large orders. For example, if the best price on an exchange is associated with 100 shares of depth, a 200 share order will exhaust depth at the best price and the second 100 share lot may execute at an inferior price.[265] If depth at the best price tends to be larger, it is less likely that an order will exceed the depth available at the best price. The change in the best price associated with an execution that exhausts the depth available at the best price is the price effect of the trade upon the exchange.

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265 This assumes no hidden depth at the best price. If non-displayed depth is present at the best price, the remaining 100 shares will be filled at the best price if at least 100 shares of hidden depth exist at the best price.

3. Competitive Effects on Off-Exchange Market Regulation

Currently, FINRA is the only Association.[266] It is possible, however, for new Associations to enter the regulatory oversight market and compete with FINRA. The amendments to Rule 15b9-1 may create incentives for a new Association (or Associations) to form. The large non-FINRA member firms have commonalities in business models; for example, they typically do not carry customer accounts. They may consider joining a new Association together, which would allow the member of the new Association to be subject to rules and regulations that better fit their business practices. This may allow the new Association to more efficiently provide oversight for current non-FINRA member firms. For example, because these firms collectively conduct a significant portion of off-exchange volume, the creation of a new Association tailored to these firms may be economically viable.

To be registered as a new Association, in addition to requirements that parallel the requirements to be a national securities exchange, a new Association must "[b]y reason of the number and geographical distribution of its members and the scope of their transactions" be able to carry out the purposes of Section 15A.[267] Any new Association would have to be approved by the Commission. Additionally, a new Association must permit any registered broker or dealer that meets a new Association's qualification standards to become a member.[268] It also must have

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266 See supra note 9 and accompanying text.

267 See 15 U.S.C. 78o-3.

268 See 15 U.S.C. 78o-3(b)(3). Section 15A of the Exchange Act specifically states that an Association shall not be registered as a national securities association unless the Commission determines, among other things, that "the rules of the association provide that any registered broker or dealer may become a member of such association and any person may become associated with a member thereof."

rules regarding the form and content of quotations relating to securities sold otherwise than on a national securities exchange that are designed to produce fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations.[269] A new Association must also be so organized and have the capacity to enforce compliance by its members and persons associated with its members with, among other things, its own rules and the Exchange Act and the rules and regulations thereunder.[270]

The ability to form an Association is characterized by barriers to entry. The proposed amendments include a one-year implementation period, which may provide a significant time constraint to form a new Association. A new Association would likely incur significant fixed costs to create the infrastructure needed to perform the surveillance and oversight requirements imposed on Associations by statute and regulation. It may also incur substantial costs, including personnel, training, travel, and other costs to provide for effective surveillance and supervision of the off-exchange equity and U.S. Treasury securities markets. Indeed, the only existing Association, FINRA, has resources that enable it to surveil and supervise the off-exchange market.[271] Additionally, while some costs may be lower because CAT already collects information and makes it available to query; a new Association would still have to build its own

269 See 15 U.S.C. 78o-3(b)(11).

270 See 15 U.S.C. 78o-3(b)(2).

271 See supra note 9 and accompanying text.

infrastructure, surveillance logics, and analytical tools, which may create a substantial cost for a new Association.[272]

The amendments may increase barriers to entry and thus affect the potential for competition among regulators of off-exchange markets. Currently, the primary barrier to entry is the high fixed cost involved in forming and operating an Association. As proposed, the amendments bring nearly all off-exchange trading under the jurisdiction of an Association, including the trading of firms that currently are not members of an Association (non-FINRA member firms). If these firms join the only existing Association, FINRA, any newly-formed Association may have increased difficulty attracting the members needed to support the high fixed costs associated with forming an Association because every broker or dealer that participates in the off-exchange market would already be a FINRA member. This increased difficulty results because many firms may be reluctant to change Associations, either because of the costs to change compliance infrastructures or uncertainty in the regulatory environment of the new Association. Thus, if the amendments result in more firms becoming members of the FINRA, a new Association could face increased difficulties attracting members in the future. If the new Association is introduced after implementation of the rule, these stated effects would become more likely as the current non-FINRA member firms would have already joined FINRA.

The proposed amendments may create incentives to start a competing Association. The amendments, as proposed, could cause a number of firms with similar business models and substantial off-exchange volume to concurrently contemplate Association membership. This

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272 See Exchange Act Release No. 79318 (Nov. 15, 2016), 81 FR 84696, 84836-39 (Nov. 23, 2016) ("CAT NMS Approval Order"), for a discussion on the benefits provided by CAT with regard to surveillance by SROs.

may provide the incentive to create a new Association and tailor it to the specific business models of these firms. If a competing Association limited the scope of its members or operations, it might not have to duplicate all of the surveillance and supervision functions required to be provided by an Association that does not have those limits. This may lower the costs of forming an Association and alter the barriers to entry.[273]

When the Commission previously considered these amendments, some commenters expressed their concern about a concentration of regulatory oversight.[274] One commenter stated that, although subjecting all brokers and dealers to FINRA oversight could create standardized rules, which would simplify compliance and allow for better regulatory oversight and would eliminate the rationale for many exchange specific requirements, it is necessary to weigh such benefits against potential negatives associated with having a single regulator.[275] A second commenter worried about an "imprudent concentration of regulatory oversight responsibility with one self-regulatory organization."[276] This commenter is concerned that the rule may achieve efficient oversight but would "do so at the certain cost of regulatory resiliency and innovation." This commenter is also concerned that the rule could lead to serious single point of failure concerns and discourage innovation in regulatory surveillance and oversight practices.[277]

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273 Some limitations on Association membership or operations would require exemptive relief for the Association to register with the Commission.

274 See HRT Letter at 9-11, CHX Letter at 1-2, and Hold Brothers Capital Letter at 3.

275 See HRT Letter at 9-10. HRT further believes that it is appropriate to consider the potential negatives of concentrating power in a single regulator while also considering the potential positives associated with better standardization. Id. at 11.

276 See CHX Letter at 1.

277 Id. at 2. The commenter believes that effective regulation of cross-market activity requires multiple reviews of the same data from the unique vantage points of the

One commenter believes that the proposal raises "[m]onopoly and [a]nticompetitive considerations."[278]

The existence of multiple Associations might provide benefits to the market as a whole. If a new Association could provide high quality services to members with a lower fee structure, all Associations would have incentives to reduce fees to attract members. This could result in cost savings to brokers and dealers. Second, a new Association could innovate to develop different surveillance and supervision methods that could be more efficient than FINRA's methods.

Competition among Associations could also entail substantial costs. If the market for Associations is characterized by economies of scale, aggregate costs for the same level of regulation would be higher in a market with two Associations than in a market with a single Association. These additional costs would ultimately be borne by the broker and dealer members of either Association, and could be passed on to investors. Second, Associations might compete on the basis of providing "light touch" regulation, in essence surveilling less and providing less supervision. As a result, the quality of market supervision might decrease, although the Commission does itself oversee self-regulatory organizations, such as Associations, and accordingly, would not permit a "race to the bottom."[279] Furthermore, some of the benefits of the proposed amendments would be diminished if current non-FINRA member firms created a new Association as opposed to joining FINRA. For example, the new Association would not

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respective SROs as is currently done with cooperation among the SROs and statutorily delegated regulatory authority.

278 See Hold Brothers Capital Letter at 3.

279 See Section 19(g) and Section 19(h) of the Exchange Act.

have the experience or expertise of FINRA in overseeing off-exchange market activity. Additionally, the members of a new Association would not be required to report their U.S. Treasury securities market trading activity to TRACE if they are not FINRA members.

C. Consideration of Costs and Benefits

This section discusses costs and benefits of the amendments. While the Commission has attempted, where possible, to provide estimated quantifiable ranges, both costs and benefits are difficult to quantify for this proposal for a number of reasons.

The overall benefits of the amendments relate to more stable and uniform surveillance of off-exchange activity by the direct, membership-based Association oversight to oversee such activity. As such, the benefits the Commission anticipates from the amendments are largely qualitative and by their nature difficult to measure quantitatively.

The amendments would induce initial, ongoing and indirect costs which would be similarly difficult to measure for a variety of reasons. First, market participants are heterogeneous in their type, existing exchange memberships, and activity level in the off-exchange market. Consequently, compliance costs would vary across firms in a number of dimensions. Second, estimating costs is complicated by the fact that non-FINRA member firms can comply with the proposal in a number of ways, and presumably each would choose to seek compliance in the manner that minimizes the sum of its direct costs (related to joining and maintaining memberships in additional SROs) and indirect costs (which include forgone opportunities to trade profitably and costs associated with revising business strategies). Furthermore, some firms are likely to remain exempt but the Commission lacks data to identify

those firms with certainty.[280] At the other end of the spectrum, the minority of non-FINRA member firms that are large and contribute significantly to both exchange and off-exchange trading are unlikely to remain exempt.[281] For the 65 non-FINRA member firms, the Commission believes that most could lose their exempt status, but cannot estimate how those firms would seek to comply with the amendments.[282]

1. Benefits

As discussed above,[283] some of the firms relying on the Rule 15b9-1 exemption are significant participants in both on and off-exchange markets.[284] For example, in September of 2021, $789 billion in listed equities was traded off-exchange by non-FINRA member firms, and $592.3 billion in listed equities was traded on an exchange that the firm did not belong to.[285] Thus, a substantial amount of off-exchange volume is conducted outside of the regulatory jurisdiction of FINRA, which under the Exchange Act has primary responsibility for overseeing

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280 Non-FINRA member firms that provide liquidity on multiple exchanges and trade heavily off-exchange are unlikely to be small in terms of net capital, and are not low trading volume firms by definition. However, as discussed in supra Section VI.A.1, many non-FINRA member firms are small in terms of net capital and may be members of a single exchange. Such firms are more likely to have limited exposure to off-exchange markets. Such firms would either be exempt from the rule by virtue of having no off-exchange trading or no trading on exchanges of which they are not members, or be able to rely on the stock-option order exemption to continue their limited off-exchange trading related to their exchange-based brokerage activities.

281 The diversity of non-FINRA member firms is discussed in supra Section VI.A.1.

282 See supra Section VI.B.1., which discusses how firms may change their business models in response to the rule.

283 See supra Section I.

284 See supra Section VI.A.1.

285 See supra Table 1.

off-exchange activity. Although FINRA has the ability to surveil 100% of cross-market and off-exchange equity trading activity, it does not have enforcement jurisdiction for firms that are not FINRA members, unless enforcement responsibility is covered under an RSA. Association membership would supplement the oversight of the exchanges, to the extent a firm remained an exchange member, and provide consistent and ongoing application of rules, which could vary between exchanges. Regarding off-exchange trading, under the current regulatory structure using RSAs, FINRA applies the rules of the different exchanges and the exchanges' interpretations of those rules to such trading. This can result in different interpretations and FINRA registration would promote consistent interpretations and efficiencies in enforcement and regulation with respect to this growing part of the market. As discussed above,[286] the Commission believes the inclusion of more non-FINRA member firms in an Association would improve such Association's ability to supervise cross-exchange trading activity, particularly in U.S. Treasury securities markets. This would enhance FINRA's ability and—through the information FINRA shares with the Commission—the Commission's ability to effectively oversee regulation of trading on equity, fixed income, and option markets.

The Commission believes that the amendments to Rule 15b9-1 would improve supervision of non-FINRA member firms. FINRA, currently the only Association, has substantial experience and expertise from overseeing a large number of brokers and dealers that trade off-exchange or across exchanges. This makes FINRA's potential regulation of non-FINRA member firms with off-exchange or cross-market trading activity particularly efficient.

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286 See supra Section I.

In addition, the amendments, as proposed, would enhance the supervision and enforcement for equities and options beyond the benefits from the CAT NMS Plan.[287] While CAT improves data accessibility for all SROs, it does not address FINRA's lack of jurisdiction over non-FINRA member firms participating in the off-exchange markets. Several commenters on the 2015 Proposal believed that reporting of non-FINRA member identifying information and activity pursuant to the CAT NMS Plan would eliminate the need for firms to join FINRA and would provide FINRA a near complete picture of off-exchange trading activity.[288] However, another commenter noted that even with non-FINRA member firm information, "enforcement activities would remain the responsibility of the individual exchanges where broker-dealers are members" even though FINRA would be best positioned to regulate off-exchange activity.[289] The Commission agrees that, although FINRA now has additional information with respect to non-FINRA member firm activity, it still lacks jurisdiction over non-FINRA member firms, and the proposed amendments would provide such jurisdiction.[290]

The benefits of the proposed amendments would be pronounced in the U.S. Treasury securities markets. A significant amount of volume in U.S. Treasury securities markets comes from broker-dealers that may be newly required to become FINRA members as a result of the proposed amendments.[291] If these broker-dealers become FINRA members, they would be

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287 See CAT NMS Approval Order, supra note 272.

288 See HRT Letter at 3, CTC Letter at 3-4, and FIA 2 Letter at 3.

289 See FINRA Letter at 4.

290 See supra section II.B.

291 The Commission estimates that four such firms accounted for $7 trillion in U.S. Treasury securities volume executed on covered ATSs in 2021 that was reported to TRACE, which was more than 2% of the total U.S. Treasury securities volume traded in 2021 that was

required to comply with FINRA rules, including TRACE reporting requirements. This could have a positive impact on market quality by increasing coverage of data reported to TRACE as well as providing additional market oversight. Non-FINRA member firms do not report to TRACE, and they are only specifically identified by MPID in TRACE when their U.S. Treasury securities trades occur on a covered ATS; they are not identified by MPID for other trades of U.S. Treasury securities that do not occur on covered ATSs, such as direct dealer-to-dealer transactions. Thus, the proposed amendments would improve the quality and coverage of TRACE data and increase regulatory transparency into the U.S. Treasury securities markets.[292] The extent of the benefits of requiring non-FINRA members to report these transactions may be limited because the Commission believes that the majority of U.S. Treasury securities transactions are already reported to TRACE.[293] However, the Commission is unable to estimate the extent of U.S. Treasury securities trading activity that is not reported to TRACE.

The Commission believes that the proposed amendments could have similar or additional benefits for other TRACE reported securities, should current non-FINRA member firms also trade in such securities. However, the Commission lacks the information necessary to discern the degree of any such benefits because, as noted above, the Commission does not have any data or other information available, unlike with U.S. Treasury securities, to determine how many non-

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reported to TRACE, and that three such firms' U.S. Treasury securities volume executed on covered ATSs in April 2022 that was reported to TRACE accounted for approximately 2.5% of total U.S. Treasury securities volume in April 2022 that was reported to TRACE. See supra Section II.B.

292 One commenter stated that all off-exchange trades are already being reported "because all off-exchange trading needs to go through a FINRA member with its own reporting obligations." See FIA 1 Letter at 3. See also supra note 70.

293 See id.

FINRA member firms, if any, actively trade in these securities or to predict how many additional trades would be reported under the proposal.[294] In addition to the potential market oversight benefits that would be similar to U.S. Treasury securities, the potential transparency improvements of TRACE reporting for other TRACE reportable securities go further than transparency improvement in U.S. Treasury securities, because the TRACE data for other TRACE reported securities is available to the public in real time through data vendors.[295] The additional transparency from more public TRACE reporting could result in improved price discovery, which would lead to lower transaction costs.[296]

While current members of an Association would not be directly affected by this rule, they would benefit by having a more level playing field in reporting trades in the U.S. Treasury securities markets. With more uniform regulatory requirements, firms may compete more equitably to supply liquidity both on exchanges and in the off-exchange market.

Although fewer firms will be able to rely on the proposed narrower exemptions, the proposed narrower exemptions would continue to provide benefits for non-FINRA members as well as other market participants. These exemptions would continue to provide cost savings for non-FINRA members as they would continue to not be required to join FINRA and thus avoid

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294 The information used to get a sense of the magnitude of unreported transactions in U.S. Treasury securities is not available for other fixed income securities. See supra Section VI.A.1.

295 See supra note 218, for information on the difference between the dissemination of TRACE for U.S. Treasury securities and TRACE for other TRACE eligible securities.

296 See Hendrik Bessembinder, Chester Spatt & Kumar Venkataraman, A Survey of the Microstructure of Fixed-Income Markets, 55 J. Fin. & Quantitative Anal. 1 (2020). See also infra Section VI.C.2.f. for a related discussion of potential costs which could apply to other FINRA reportable securities.

the costs of doing so. Additionally, the routing exemption would facilitate regulatory compliance designed to improve market quality.[297] The Commission also believes that the stock-option order exemption would facilitate liquidity in both stock and options markets, which could improve market quality.[298]

2. Costs

The amendments, by narrowing the existing exemption, would result in brokers and dealers that no longer qualify for the exemption having to comply with Section 15(b)(8) by either limiting their trading to exchanges of which they are members, joining an Association or abiding by one of the stated exemptions. Under the amendments, therefore, non-FINRA member firms that choose to continue any off-member-exchange activity will be faced with choices that would involve corresponding costs. For example, non-FINRA member firms may incur costs related to membership in an Association or costs necessitated by additional exchange memberships. Additionally, some non-FINRA member firms may incur the costs of losing the benefits of trading in the off-member-exchange market if they decide not to join an Association. There could also be indirect costs associated with the proposed amendments, depending on if a non-FINRA member chooses to join an Association or not.

Most of the direct costs incurred in joining an Association and maintaining membership therein are dependent on firm characteristics and activity level. Furthermore, the Commission believes that some non-FINRA member firms may comply by ceasing their off-member-exchange trading activity, avoiding many of these costs but forgoing the opportunity to trade

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297 See supra Section III.B.1 for more information on the purpose of the routing exemption.

298 See supra Section III.B.2 for more information on the stock-options order exemption.

profitably in some venues. If all 12 of the non-FINRA member firms that have significant off-member-exchange trading activities in equities were to join FINRA, the median aggregate cost of the amendment for these firms would be about $95,000 in implementation costs and median ongoing aggregate annual costs of about $2.7 million.[299] The aggregate costs for the subset of 12 represent the majority of the aggregate costs. The Commission believes that smaller non-FINRA member firms as well as new entrants would experience much lower costs. In particular, the initial costs for such firms would be close to the lower range discussed below, because these cost are largely dependent on the size and complexity of the firms. Additionally, because smaller firms and new entrants would have lower trading activity, the ongoing costs would also be significantly lower as ongoing costs are highly impacted by the trading activity.

a. Costs of Joining an Association[300]

Based on discussions with FINRA,[301] and industry participants, the direct compliance costs on non-FINRA member firms of joining FINRA are composed of FINRA membership

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299 See Table 3 and Table 4, infra, for a breakdown of these costs. The 2015 Proposing Release, supra note 6, estimated these costs to be much higher as the estimates included costs for reporting transactions for NMS stocks. These transactions are now reported to CAT and are therefore not included in our estimates here.

300 The Commission recognizes that non-FINRA member firms would incur compliance costs on an initial and ongoing basis to comply with the proposed amendments. These costs include costs for training and hiring new employees, as well as additional costs for exams and licensing required by FINRA. The Commission does not aggregate these costs across all non-FINRA member firms because the Commission does not have necessary information about the majority of the non-FINRA member firms and expects that costs would vary widely across firms. Where possible, however, the Commission has provided estimates based on a subset of large firms on which the Commission has sufficient information. The Commission expects that smaller firms likely will face lower costs.

301 See FINRA Letter at 5-7.

application fees and any legal or consulting costs necessary for effectively completing the application to become a member of FINRA (e.g., ensuring compliance with FINRA rules including drafting policies and procedures as may be required).

The fees associated with a FINRA membership application can vary. As an initial matter, the application fee to join FINRA is tier-based according to the number of registered persons associated with the applicant. This one-time application fee ranges from $7,500 to $55,000.[302] The initial membership fee for FINRA is $7,500 for firms with ten or fewer representatives registered with FINRA, $12,500 for firms with 11 to 100 representatives registered with FINRA, and $20,000 for firms with 101 to 150 representatives registered with FINRA.[303] Based on its knowledge of the size and business models of non-FINRA member firms, the Commission believes that the median application fee for the 12 largest firms would be $12,500 and that most non-FINRA member firms would not incur FINRA application fees exceeding $20,000.[304]

In addition to the application fees and data reporting costs, the Commission has taken into account the cost of legal and other advising necessary for effectively completing the application to be a member of FINRA. Some firms may choose to perform this legal work internally while others may use outside counsel for the initial membership application. In making this choice, non-FINRA member firms would likely take into account factors, such as the size and resources of the firm, the complexity of the firm's business model, and whether the firm previously used outside counsel to register with any exchanges. Based on conversations with

302 See FINRA By-Laws, Schedule A, Section 4.

303 Id.

304 Based on 2022 FOCUS data, no non-FINRA member firm has more than 150 registered representatives.

industry participants that assist with FINRA membership, for non-FINRA member firms that choose to employ outside counsel to assist with their FINRA membership application, the cost of such counsel ranges from approximately $40,000 to $125,000, with a midpoint of $82,500. Factors affecting the specific costs of a particular firm include the number of associated persons, the level of complexity or uniqueness of the firm's business plan, and whether the firm has previously completed exchange membership applications with similar requirements.

Table 3: Median Firm Implementation Costs[1]

Cost	Median
Application to join FINRA	$12,500
Legal consulting	$82,500
Total	$95,000

1. Medians are used where possible. Cost estimates are for the 12 largest firms. Cost estimates are reported as ranges for legal consulting and compliance work; for these estimates, the midpoint is used.

b. Costs of Maintaining an Association Membership

With respect to ongoing costs, three components of such costs are any ongoing fees associated with FINRA membership, costs of legal work relating to FINRA membership, and costs associated with additional compliance activities. The ongoing membership-related fees associated with FINRA membership include the annual GIA; and the TAF and Section 3 fees, among others.[305]

305 There are additional fees associated with maintaining a FINRA membership. There are also additional continuing education and testing requirements, which will impose costs upon firms joining FINRA. Additionally, there are de minimis fees (branch registration

With certain assumptions, the Commission attempted to estimate direct compliance costs that a non-FINRA member firm is likely to face to comply with the amendments. The estimate applies to the 12 non-FINRA member firms that have significant off-member-exchange trading activities; smaller firms should face lower costs compared to these 12 firms because they have less revenue and trading volume that would be subject to GIA, TAF and Section 3 fees. Though non-FINRA member firms may already indirectly bear some of these costs as they may be passed through by FINRA member counterparties. Ongoing annual cost estimates (one time and annual) are broken down in Table 2.

The annual GIA generally requires members to pay a percentage of the member firm's total annual revenue based on a graduated scale.[306] The magnitude of the annual GIA is based on the total annual revenue, excluding commodities income, reported by the member firm on its FOCUS Form Part II or IIA.[307] Based on FOCUS Form data from 12 non-FINRA member firms in 2022, the Commission has determined that the average annual total revenue of non-FINRA member firms, excluding commodities income, is approximately $1.3 billion, with a median of

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fee and system processing fee, among others). See FINRA By-Laws, Schedule A. The Commission also believes that non-FINRA member firms would not need to register additional associated persons because the exchange SRO rules are already comprehensive in this regard. See infra Section VI.C.2.d.

306 See FINRA By-Laws, Schedule A. For example, FINRA imposes a GIA as follows: (1) $1,200 on a member firm's annual gross revenue up to $1 million; (2) a charge of 0.1215% on a member firm's annual gross revenue between $1 million and $25 million; (3) a charge of 0.2599% on a member firm's annual gross revenue between $25 million and $50 million; and so on as provided in Schedule A. When a firm's annual gross revenue exceeds $25 million, the maximum of current year's revenue and average of the last three years' revenue is used as the basis for the income assessment.

307 See FINRA By-Laws, Schedule A, Section 2. See also FOCUS Report Form X-17A-5, Part II and IIA.

$906 million.[308] For the 12 large firms, FINRA's graduated GIA scale results in a median GIA of $459,849.51.[309]

The magnitude of the TAF depends on the transaction volume of a FINRA member that is covered by the TAF as described in the FINRA By-Laws.[310] To the extent FINRA changes the structure of the TAF to take into account the business models of non-FINRA member firms that may join FINRA as a result of the proposed amendments, these costs may change.[311] The Commission has identified 12 non-FINRA member firms that have significant off-member-exchange trading activity in September of 2021. The Commission estimates that trading activity fees for off-member-exchange equity trading incurred by these 12 large non-FINRA member firms due to their off-member-exchange activity would have an average incurred TAF of around $273,677.87 with a median TAF of $132,744.50.[312] However, this cost is likely to be

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308 Based on 2022 FOCUS data.

309 ($1,200 for the first $1 million of revenue) + (0.1346% × annual revenue greater than $1 million up to $25 million) + (0.2880% x annual revenue greater than $25 million up to $50 million) + (0.0574% of annual revenue greater than $50 million up top $100 million) + (0.0404% of annual revenue greater than $100 million to $5 billion) + (0.0440% of annual revenue greater than $5 billion up to $25 billion) + (0.0948% of annual revenue greater than $25 billion). Although the average annual total revenue exceeds the median annual total revenue, there are a number of firms that have low GIA, which causes the midpoint of GIA to exceed the average GIA. Non-FINRA member firms vary in size. GIA for the 12 largest firms used in these calculations, is anticipated to be far larger than for the 65 remaining non-FINRA member firms. See FINRA By-Laws, Schedule A, Section 1(c).

310 See FINRA By-Laws, Schedule A, Section 1(b).

311 FINRA proposed amendments to the TAF in May of 2015. See supra note 241.

312 Estimated TAF includes only the off-exchange equity portion of the TAF and does not include any TAF related to a firm's exchange-based trading activity. If a firm's activity on an exchange is related to normal market making operations, the activity does not incur the TAF. The Commission is unable to estimate the proportion of these firms' exchange trading that would incur the TAF because the Commission does not have information on

underestimated, as the estimate only accounts for off-exchange equity activity, and the magnitude of the underestimate may be significant.[313] The Commission believes that the TAF for non-FINRA member firms not among the 12 identified would be far lower because the median non-FINRA member firm has far lower trading volume than the typical firm of the 12 identified in the data.

Some off-exchange trading that non-FINRA member firms engage in currently may no longer be profitable when TAF is incurred. Consequently, non-FINRA member firms may reduce their trading both on exchanges and off-exchange after joining an Association.[314]

In May of 2015, FINRA issued a Regulatory Notice proposing to amend the TAF such that it would not apply to transactions by a proprietary trading firm effected on exchanges of which the firm is a member, to coincide with originally proposed changes to 15b9-1.[315] To the

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what proportion of non-FINRA member firm exchange activity would qualify for exemption from the TAF under FINRA By-Laws. Because other elements of the TAF are not included in this calculation, it underestimates the actual TAF that firms would incur if they joined FINRA. The magnitude of the underestimation may be significant, but firms that join FINRA may be able to reduce their TAF cost by registering as market makers upon additional exchanges. (The TAF is not assessed for certain trades related to registered market-making.) See FINRA By Laws, Schedule A, Section (1)(b)(2)(F). Estimates of the TAF are based on the off-exchange sell volume reported to CAT for each of the 12 large non-FINRA member firms. The estimated TAF is equal to estimated off-exchange sell volume x $0.00013. The $0 minimum is associated with a firm that has almost no off-exchange volume.

313 FINRA members are required to pay the TAF for on and off-exchange trading activity across multiple asset classes. However, there are exemptions for certain trading activity and the Commission is unable to identify all trades that are subject to such exemptions. See https://www.finra.org/rules-guidance/rulebooks/corporate-organization/section-1-member-regulatory-fees for an explanation of the TAF and the relevant exceptions.

314 See supra Section VI.B.1 for more information on how firms may change their trading practices in response to the rule.

315 See supra note 153.

extent FINRA contemplates proposing similar changes to the TAF, if approved, this could lower the cost for non-FINRA member firms.[316] FINRA's previously proposed TAF amendments would exempt proprietary trading firms when they trade securities on exchanges of which they are a member, which several commenters supported.[317]

In addition to the TAF, non-FINRA member firms that choose to join FINRA may incur additional Section 3 fees. Using data on off-exchange trading during September 2021, the Commission estimated that Section 3 fees incurred by the 12 large non-FINRA member firms due to their off-exchange trading would have an average incurred Section 3 fee of $4,541,719.31 annually, with a median incurred Section 3 fee of $2,150,069.99.[318] Some of these fees may already be paid by non-FINRA member firms that engage the services of a member firm clearing broker. However, FINRA lacks the authority to assess Section 3 fees against non-FINRA

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316 In the 2015 Proposing Release, supra note 6, the Commission solicited comment on the effect of the proposed TAF amendments, including the effect should the TAF be assessed to non-FINRA member firms that choose to become FINRA members. With regard to the TAF, one Commenter stated that "it is impossible… to estimate the impact of this potentially significant cost." See CTC Letter at 5. Another commenter shared similar thoughts. See FIA 1 Letter at 2. However, of the commenters that discussed this issue, most were in support of the TAF amendments. See FIA 2 Letter at 2, CTC Letter at 5, IEX Letter at 3, and HRT Letter at 11. For example, one commenter believes that "[c]hanges to TAF fees alone could potentially reduce the total costs of the Proposal to some firms by 90% or more." See FIA 2 Letter at 2.

317 See IEX Letter at 3, PEAK6 Letter at 3, and HRT Letter at 5.

318 Section 3 fees are estimated using non-FINRA member firm off-exchange sell dollar volume calculated in CAT. The Section 3 fee obligation is calculated as: Non-FINRA member firm Sell Dollar Volume x $22.90/$1,000,000. The $22.90/ $1,000,000 is the FINRA fee rate for Fiscal Year 2022. See FINRA By-Laws of the Corporation, Schedule A to the By-Laws of the Corporation, Section 3 – Regulatory Transaction Fee. See also Exchange Act Release No. 94644 (April 8, 2022), 87 FR 21931 (April 13, 2022) and press release, Commission, Fee Rate Advisory #1 for Fiscal Year 2022 (April 8, 2022), available at https://www.sec.gov/news/press-release/2022-60.

member firms, in which case FINRA may assess the fee to the member firm counterparty to the transaction. In these cases, the FINRA-member may pass-through a portion of the fee to the non-FINRA member counterparty. While these fees would represent a cost to non-FINRA member firms, the cost would be largely offset to the industry as a whole by a reduction of Section 3 fees incurred by member firms (or clearing brokers acting on behalf of a member firm) when they buy from a self-clearing, non-FINRA member firm.[319]

Ongoing compliance costs would depend on the business circumstances of each firm and the types of issues that could arise. As in the case of the initial membership, some non-FINRA member firms may choose to conduct ongoing compliance activities in-house while others may seek to outsource this work.[320] Based on discussions with industry participants, the Commission estimated that the ongoing compliance cost for firms that outsource this work would range from $24,000 to $96,000 per year, with a median of $60,000.[321] In the case of some non-FINRA member firms, i.e., those that are affiliates of FINRA members, this cost is likely to be lower as they may be able to leverage compliance work already being performed.

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319 Currently, when the sell side of an off-exchange transaction is a non-FINRA member firm, FINRA may assess the Section 3 fees on the buy side counterparty. See the discussion of Section 3 fees in Section VI.A.2, supra, for more information.

320 Ongoing compliance activities may include core accounting functions, updating policies and procedures, and updating forms filed with regulators.

321 For firms that choose to do this work in-house, the Commission estimates that the costs of ongoing compliance may be less than $96,000. This figure assumes non-FINRA member firms may have experience in ongoing compliance work with SROs through their exchange membership(s) and, therefore, only captures the incremental cost of compliance with Association rules.

FINRA members may also be required to pay the median Personnel Assessment.[322] The annual Personnel Assessment fee ranges from $130 to $150 per employee and applies to principals or representatives in the FINRA member's organization. Using FOCUS data the Commission estimates that the average non-FINRA member firm would incur a Personnel Assessment fee of no more than $1,960, and the median non-FINRA member firm would incur a Personnel Assessment fee of $0.[323] The Commission further estimates that the maximum Personnel Assessment fee incurred by one of these non-FINRA member firms would be $18,330.

The Commission estimates that the median ongoing cost for non-FINRA member firms would be $2,742,664. However, as discussed above, these costs could vary. The Section 3 fees which make up a large portion of these costs are likely to be overestimated for reasons stated above. Additionally, the TAF is likely to be underestimated.

Table 4: Median Firm Ongoing Annual Costs[1]

Cost	**Median or Average**
Gross Income Assessment	$459,849.51
Trading Activity Fee	$132,744.50
Personnel Assessment	$0
Section 3 fee	$2,150,069.99
Compliance work	$60,000
Total	$2,742,664

1. See infra note 312 and accompanying text. The TAF cost also represents a transfer from current non-FINRA member firms to current member firms. The TAF is calculated using off-exchange sell volume from CAT. The Section 3 fee estimate assumes that the firms currently pay no Section 3 fees. It is likely that firms that clear through a member firm are currently

322 See FINRA By-Laws, Schedule A, Section 1(e).

323 Based on 2022 FOCUS data, the number of registered representatives of non-FINRA member firms that connect directly to ATSs ranges from 0-163, with an average of 29 and a median of 0.

assessed these fees indirectly. Median Personnel Assessment Fees are estimated to be zero based on analysis using FOCUS data. See supra note 323.

In addition to the cost estimates discussed above, the Commission recognizes that both non-FINRA member firms and SROs would incur other direct and indirect costs because of the increased regulatory requirements of the amendments. Specifically, there would be compliance costs associated with regulation by FINRA.[324] Additional costs would include actions that are required to accommodate normal supervision and examination by an Association. To the extent that they do not already do so, firms would face additional costs related to coming into compliance with Association rules. The Commission was not able to estimate these costs, although the costs would vary among non-FINRA member firms.

Two commenters on the 2015 Proposal submitted estimates for the cost of becoming FINRA members.[325] In addition, many commenters stated that FINRA fees would be substantial and constitute a considerable sum,[326] believing that FINRA fees would be unduly burdensome and outweigh perceived benefits.[327] Several commenters believed in particular that FINRA

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324 However, non-FINRA member firms that choose to join an Association may have FINRA assigned as their DEA. Such an assignment could eliminate separate DEA fees that the non-FINRA member firms may pay to their current DEA.

325 See CTC Letter at 5 (Estimating initial costs of $3.5 million and ongoing annual costs of $1.5 million per year), and FIA 2 Letter at 5 (Estimating initial costs of between $200,000 and $250,000 and ongoing costs of $100,000 per year).

326 See FIA 1 Letter at 1 ("FINRA Membership would be costly to most proprietary trading firms"); PEAK6 Letter at 2 ("FINRA registration process is overly costly and burdensome"); Hold Brothers Capital Letter at 2 ("[Costs of FINRA membership] would be unduly burdensome to smaller, less well funded Proprietary Traders"); Lakeshore Letter at 2, CTC Letter at 6, D&D Letter at 2, and PTR Letter at 2.

327 See Peak6 Letter at 2, D&D and PTR Letters at 2, Hold Brothers Capital Letter at 2, Lakeshore Letter at 3, and FIA 1 Letter at 2.

membership would be costly to proprietary trading firms with no customer business.[328] One commenter noted generally that FINRA should review its fees to ensure that those fees are proportionate to the actual costs of regulation.[329] By contrast, one commenter noted that additional regulatory costs associated with FINRA membership would be "manageable" compared to the cost of the TAF.[330] As stated above, to the extent FINRA amends the TAF consistent with what was previously proposed, the ongoing costs could be lower than these estimates.

One commenter was concerned that FINRA's membership fees would only rise with no competitive forces to restrain the increase of such fees.[331] Furthermore, another commenter stated that FINRA membership fees are substantially higher than fees charged by some of the exchanges for DEA services.[332] Several commenters also raised the concern that FINRA may get paid twice for its regulatory oversight—once, directly from the FINRA membership, and again, from the SROs that have outsourced regulatory oversight to FINRA through RSA agreements.[333] However, FINRA fees must be filed with the Commission and such fees must be consistent with the Exchange Act.[334]

c. Costs of TRACE Reporting for Non-FINRA Member Firms that Trade U.S. Treasury Securities

328 See FIA 1 Letter at 1, FIA 2 Letter at 2, and Hold Brothers Capital Letter at 2.

329 See SIFMA Letter at 3.

330 See HRT Letter at 5.

331 See CTC Letter at 6.

332 See HRT Letter at 5.

333 See CTC Letter at 6, SIFMA Letter at 3, D&D Letter at 2, and Lakeshore Letter at 3.

334 See supra note 154.

Additionally, to the extent that a firm trades fixed income securities, they would also have implementation and ongoing costs associated with TRACE reporting. The Commission believes that four non-FINRA member firms have significant trading activities in U.S. Treasury securities markets. The Commission estimates that these firms will each have an initial cost of $2,025, associated with setting up systems for TRACE reporting. This cost includes the Direct Circuit Connectivity Fee for TRACE reporting through Nasdaq, in which Nasdaq facilitates the reporting to TRACE. FINRA does not charge a Transaction Reporting Fee for trading activity in U.S. Treasury securities markets.[335] The Commission estimates an aggregate ongoing cost for each firm of $125,100. There are three ways for firms to connect into TRACE. First, firms may directly report with the FIX protocol through Nasdaq, who is the vendor. Second, firms may use a third party service bureau with FIX protocols to submit to TRACE. The costs of reporting via FIX protocols are outlined in Tables 3 and 4. The Commission does not have estimates for the cost of third party reporting to TRACE. Finally, firms with lower reporting requirements have the option of reporting using the Secure Web Interface known as FINRA TRAQS for a fee of $20 per month, which would allow these firms to avoid port fees and connection fees to Nasdaq's FIX reporting system. Additionally, costs for these firms could be significantly lower for firms with low volume, as the reporting cost is based on the volume. To the extent that non-FINRA member firms trade in other TRACE reportable securities, such firms would also have higher reporting costs. If those firms trade U.S. Treasury securities, their implementation costs

335 TRACE charges a Transaction Reporting Fee for TRACE reported securities other than U.S. Treasury securities. The fee is as follows: $0.475/trade for trade size up to and including $200,000 par value; $0.000002375 times the par value of the transaction (i.e., $0.002375/$1000) for trade size over $200,000 and up to and including $999,999.99 par value; $2.375/trade for trade size of $1,000,000 par value or more.

would be included in the Commission's estimates above and they would incur only the additional marginal costs caused by their volume in other TRACE-reportable securities. However, to the extent that some non-FINRA member firms trade in other TRACE reportable securities but not U.S. Treasury securities, those firms would each incur implementation costs as described above. The Commission cannot estimate how many firms would be in this group of non-FINRA member firms that trade TRACE-reportable securities but not U.S. Treasury securities because the Commission can identify non-FINRA member counterparties in TRACE only for U.S. Treasury securities transactions that occur on covered ATSs, as discussed previously.[336]

Table 5: Average Firm TRACE Reporting Implementation Costs

Cost	**Median or Average[1]**
FIX Port fee	$575
Direct Circuit Connectivity Fee for TRACE reporting through Nasdaq	$1,500
Total	$2,025

1. Medians are used where possible. Direct Circuit Connection Fees can be found at http://nasdaqtrader.com/Trader.aspx?id=PriceListTrading2.

Table 6: Average Firm TRACE Reporting Ongoing Annual Costs

Cost	**Median or Average[1]**
Systems Fees	$4,800
Data Fee	$90,000
Nasdaq Connection Fee	$30,000
Rule 7730 Service Fee	$300

336 See supra Section VI.A.1.

Total	$125,100

1. The systems fee is calculated using Level II Full Service Web Browser Access fee for four datasets at $140 a month plus a subscription for four additional user IDs at $260 per month for a total of $400 per month multiplied by 12 months, for an annual systems fee of $4,800. Data Fees are calculated using $7,500 per month flat fee for the professional real time data display. Connectivity fee is calculated at $2,500 a month for an annual cost of $30,000. Fees can be found at https://www.finra.org/rules-guidance/rulebooks/finra-rules/7730. Nasdaq FIX connection fees can be found at http://nasdaqtrader.com/Trader.aspx?id=PriceListTrading2.

d. Costs of Joining Additional Exchanges Under the Rule as Amended

Non-FINRA member firms must be members of all exchanges upon which they transact business if they decide not to join an Association. With limited exceptions for some excluded activity, some non-FINRA member firms may choose to join additional exchanges to be excluded from the requirement to become a member of an Association. Alternatively, these firms may cease trading on exchanges of which they are not members.

Based on discussions with FINRA and industry participants, the Commission understands that completing a membership application with an additional exchange is generally less complicated and time consuming than completing a membership application with FINRA. Consequently, the Commission believes that the compliance burden on non-FINRA member firms for joining an additional exchange is likely to be significantly less than that of joining FINRA as those non-FINRA member firms that choose to join an additional exchange are likely able to perform this work internally, given that they are already members of at least one exchange, and that such work should take less time than the time required to complete an application with FINRA. However, the aggregate cost of joining multiple exchanges would likely be more costly than the cost of joining FINRA.

In addition to the legal burden, non-FINRA member firms joining additional exchanges as a result of the proposed amendments would incur membership and related fees. To the extent that non-FINRA member firms choose to become members of additional exchanges, the fees associated with such memberships would vary depending on the type of access sought and the exchanges of which non-FINRA member firms choose to become members.

The Commission also believes that the exchange membership fees that would apply to non-FINRA member firms joining such exchanges would be those fees that apply to either introducing brokers or dealers or proprietary trading firms. This assumption is consistent with the fact that any brokers or dealers carrying customer accounts could not qualify for the current exemption of Rule 15b9-1. Thus, any exchange membership fees that apply to firms that provide clearing services or conduct a public business would not apply to non-FINRA member firms.

Furthermore, because all non-FINRA member firms are members of at least one exchange,[337] they would have already completed a Form U4, to register associated persons.[338] The Commission believes non-FINRA member firms would not need to register additional associated persons because the exchange SRO rules already require them to register associated persons. The Commission understands that all exchanges can access the Form U4 filings within the CRD which is maintained by FINRA.

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337 For a broker or dealer to possibly be exempt from the requirement to be an Association member currently or under the amendments, the broker or dealer must be a member of at least one exchange.

338 Form U4 is the Uniform Application for Securities Industry Registration or Transfer. Representatives of brokers and dealers, investment advisers, or issuers of securities use Form U4 to become registered in the appropriate jurisdictions and/or with SROs. All SROs currently use Form U4. See, e.g., Cboe BYX Rule 2.5 Interpretations and Policies .01(c), and Nasdaq PHLX Rule General 3, Section 7.

To obtain estimates of the cost of joining additional exchanges, the Commission reviewed the membership-related fee structures of all twenty-four national securities exchanges. In assuming that the potential burden of joining additional exchanges would likely be less than that of joining FINRA, the Commission assumes that the costs imposed on non-FINRA member firms by the amendments would be membership fees, and not costs relating to trading, such as trading permit fees and connectivity fees. The Commission recognizes that membership alone in an exchange may not guarantee the ability to trade because many exchanges charge fees for trading rights, ports, various degrees of connectivity, and floor access and equipment, should those be desired. The fees associated with trading on an exchange are not the result of the amendments because, under the amendments, a non-FINRA member firm could continue to trade through another broker or dealer on an exchange as long as that non-FINRA member firm is a member of every exchange on which it trades or is a member of FINRA. In other words, the amendments themselves do not impose the cost of connectivity and related fees, but only the costs associated with membership on exchanges on which non-FINRA member firms could trade. To the extent, therefore, that non-FINRA member firms continue to trade through other brokers or dealers in a manner consistent with how they currently operate, the amendments impose only the costs associated with membership.

To arrive at estimates of the cost of joining additional exchanges, the Commission aggregated any fees associated with a firm's initial application to an exchange ("initial fee") and separately aggregated the fees associated with any monthly or annual membership costs to obtain a separate annual cost ("annual fee"). Based on these aggregations, the Commission obtained a range for both the initial fee and the annual fee across exchanges. The initial fee is as low as $0

for some exchanges. Most exchanges have an initial fee that is greater than $0 and no more than $5,000.[339]

Regarding monthly or annual membership fees, most exchanges' ongoing monthly or annual membership fees generally range from $1,500 to $7,200.[340] Again, these ongoing exchange membership costs are generally lower than the annual costs estimated for being a member of FINRA.

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339 IEX does not assess any initial fees. See IEX Exchange Fee Schedule, available at https://exchange.iex.io/resources/trading/fee-schedule/ (last visited July 22, 2022) (omitting any mention of an initial membership fee). Other exchanges do have initial application fees. See, e.g., Nasdaq ISE Fee Schedule, Options 7, Section 9, available at https://listingcenter.nasdaq.com/rulebook/ise/rules/ise-options-7 (last visited July 22, 2022) (assessing a one-time application fee of $3,500 for an "Electronic Access Member"); Membership Application for New York Stock Exchange LLC and NYSE American LLC at 2 (Oct. 2019), available at https://www.nyse.com/publicdocs/nyse/markets/nyse/NYSE_and_American_Membership_Application.pdf (last visited July 22, 2022) (discussing the Non-Public Firm Application Fee of $2,500); Nasdaq Price List, available at http://www.nasdaqtrader.com/Trader.aspx?id=PriceListTrading2 (last visited July 22, 2022) (discussing the Nasdaq Application Fee of $2,000); Cboe Fee Schedule at 10 (June 30, 2022), available at https://cdn.cboe.com/resources/membership/Cboe_FeeSchedule.pdf (last visited July 22, 2022) (typically assessing a trading permit holder organization application fee on all of its members of $5,000). If a firm is organized as a sole proprietorship, the application fee for Cboe is only $3,000. Id.

340 See, e.g., Cboe BYX Exchange, Inc. Fee Schedule (eff. May 2, 2022), available at https://www.cboe.com/us/equities/membership/fee_schedule/byx/ (last visited July 22, 2022) (noting an annual membership fee of $2,500); Cboe EDGA Exchange, Inc. Fee Schedule (eff. Apr. 1, 2022), https://www.cboe.com/us/equities/membership/fee_schedule/edga/ (last visited July 22, 2022) (same); NYSE Chicago, Inc. Fee Schedule (updated Jan. 2, 2022), available at https://www.nyse.com/publicdocs/nyse/NYSE_Chicago_Fee_Schedule.pdf (last visited July 22, 2022) (assessing an annual membership fee of $7,200); MIAX Fee Schedule at 20 (Mar. 1, 2022), available at https://www.miaxoptions.com/sites/default/files/fee_schedule-files/MIAX_Options_Fee_Schedule_03012022.pdf (last visited July 22, 2022) (assessing a monthly trading permit fee for an "Electronic Exchange Member" of $1,500).

e. Policies and Procedures Related to the Narrowed Criteria for Exemption from Association Membership

Non-FINRA member firms that choose not to join an Association but wish to continue to trade off-exchange (or on exchanges of which they are not members) must do so in a manner that conforms to the routing or stock-option order exemptions. To rely on the stock-option order exemption, the proposal would require non-FINRA member firms to establish, maintain, and enforce policies and procedures as discussed above.[341] The Commission estimates that firms would incur a burden of 8 hours in initially preparing these policies and procedures.[342] Furthermore, the burden of maintaining and enforcing such policies and procedures, including a review of such policies at least annually, would be approximately 48 hours.[343] The Commission estimated an initial implementation cost of approximately $2,561 and an annual ongoing cost of approximately $15,708 for non-FINRA member firms that wish to utilize the exemptions and perform this work internally; for firms that outsource this work, costs are likely to be higher.[344]

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341 See supra Section III.B.2.

342 This figure is based on the following: (Compliance Manager at 5 hours) + (Compliance Attorney at 2.5 hours) + (Director of Compliance at 0.5 hours) = 8 burden hours per dealer. See infra note 357. As is discussed in more detail in the Paperwork Reduction Act discussion, the Commission based this estimate on the estimated burdens imposed by other rules applicable to brokers and dealers, such as Regulation SBSR. See also infra note 359.

343 This figure is based on the following: (Compliance Manager at 30 hours) + (Compliance Attorney at 12 hours) + (Director of Compliance at 6 hours) = 48 burden hours per broker or dealer. See infra note 358.

344 For firms that perform this work internally, the initial cost estimate assumes 5 hours of work performed by a Compliance Manager at an hourly rate of $293, 2.5 hours performed by Compliance Attorneys at an hourly rate of $346, and 0.5 hour of work performed by the Director of Compliance at an hourly rate of $461. The annual cost estimate assumes 30 hours of work by a Compliance Manager at an hourly rate of $293, 12 hours by Compliance Attorneys at an hourly rate of $346, and 6 hours by the Director of Compliance at an hourly rate of $461. Hourly salary figure is from SIFMA's

Firms that choose to join FINRA would not incur these costs as the exemptions would not be relevant.

f. Indirect Costs

In addition to possibly incurring costs related to joining exchanges, non-FINRA member firms that choose not to join an Association would lose the benefits of trading in off-member-exchange markets. As mentioned above, non-FINRA member firms are significant participants in off-exchange activity. Much of this trading is attributed to 12 non-FINRA member firms, and the activity level across those firms varies widely. The Commission estimates that those 12 non-FINRA member firms executed $744 billion in off-exchange volume in September of 2021, while the remaining non-FINRA member firms executed $46 billion. The Commission cannot estimate the likelihood of these firms choosing to cease off-exchange activity rather than joining an Association. One commenter echoed these concerns when it stated that non-members may "curtail all off-exchange trading" if the high costs of FINRA membership outweigh the profits.[345] The commenter believes that some firms may withdraw their broker or dealer registration and trade as a customer of a broker or dealer in order to eliminate other membership costs.[346] The Commission believes that this is a possibility and could result in less competition and could degrade market quality and regulatory oversight.[347]

Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800 hour work-year and inflation and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

345 See HRT Letter at 10.

346 Id.

347 Id.

Finally, those firms that choose not to join an Association would be limited in their ability to route their own transactions to comply with the requirements of Regulation NMS and the Options Linkage Plan.[348] Their transactions would have to be routed through a broker or dealer of an exchange of which they are a member, or routed by a broker or dealer only to those exchanges of which they are members. The routing of orders of non-FINRA member firms that do not join an Association would be determined by the routing broker or dealer of the exchanges of which they are members. This loss in choice could lead to higher costs for routing and costs associated with increased latency because the exchange's routing broker or dealer may have a telecommunications infrastructure that is inferior to that of the broker or dealer that previously provided connectivity to that exchange to the non-FINRA member firm.[349]

D. Alternatives

1. Include a Floor Member Hedging Exemption

The Commission could provide an exemption from Association membership if a dealer that meets the criteria of paragraphs (a) and (b) of the rule, conducts business on the floor of a single exchange, and its trading elsewhere is proprietary and solely for the purpose of hedging its floor-based exchange trading activity on its member exchange. The hedging exemption could be limited to firms that trade on the floor of a national securities exchange. Specifically, the alternative would provide that a dealer that conducts business on the floor of only a single

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348 The exemption related to routing to comply with Regulation NMS and the Options Linkage Plan is discussed in supra Section III.B.1.

349 Firms in the business of providing connectivity to exchanges are likely to compete on the basis of their technology. The Commission assumes that some firms that do not join FINRA will have some orders (those governed under the Regulation NMS or the Options Linkage Plan provisions to prevent trade-throughs) routed using technology inferior to the technology of their firm of choice.

national securities exchange may affect transactions in securities otherwise than on that exchange, for the dealer's own account with or through another registered broker or dealer, that are solely for the purpose of hedging the risks of its floor-based exchange activity, by reducing or otherwise mitigating the risks thereof. The alternative proposal also could require a dealer seeking to rely on this exemption to establish, maintain, and enforce written policies and procedures reasonably designed to ensure and demonstrate that such hedging transactions reduce or otherwise mitigate the risks of the financial exposure the dealer incurs as a result of its floor-based activity, and to preserve a copy of its policies and procedures in a manner consistent with 17 CFR 240.17a-4 until three years after the date the policies and procedures are replaced with updated policies and procedures.

The Commission believes that this alternative could provide a limited exemption from Association membership that is consistent with the original design of Rule 15b9-1's exclusion for proprietary trading. Today, few dealers limit their quoting and other non-hedging trading activities to a particular exchange. Under this alternative, the registered dealers among this group that limit their primary trading business to a single exchange floor may continue to hedge the risk of that business by effecting securities transactions on another exchange or in the off-exchange market that are solely for the purpose of hedging the dealers' on-exchange activity, without such transactions triggering a requirement to join an Association.

The Commission also believes that this alternative approach, and in particular the limitation of its coverage to dealers that engage in floor trading and are a member of only a single exchange, could be consistent with the public interest and the protection of investors. A dealer's hedging activity resulting from its trading activity on multiple exchanges of which the dealer is a member presents cross-market surveillance concerns as previously discussed, and

therefore FINRA would be in the best position to conduct regulatory oversight to the extent that the dealer's hedging transactions take place elsewhere than on exchanges of which it is a member. By contrast, so long as a dealer's hedging activity results from floor trading activity that is confined to a single exchange of which the dealer is a member, that exchange could be able to adequately supervise the hedging activities of the dealer, consistent with the public interest and protection of investors.

In addition, requiring written policies and procedures, as described above, would facilitate exchange supervision of dealers relying on such floor member hedging exemption, as it could provide an efficient and effective way for the relevant exchange to assess compliance with the proposed exemption. This could further serve the public interest and help protect investors.

Because the alternative hedging exemption for floor traders is intended to allow a dealer to reduce or otherwise mitigate its risk, such as position risk, incurred in connection with its exchange-based dealer activities, it would be limited to transactions for the dealer's own account. In addition, because the dealer would not itself be a member of any other national securities exchange on which hedging transactions may be effected, or of an Association, such transactions would need to be conducted with or through another registered broker or dealer that is a member of such other national securities exchange or a member of an Association (or of both).

However, the Commission believes that this alternative exemption would currently apply to very few and as little as zero non-FINRA member firms. Given that so few non-FINRA member firms would qualify for the exemption, the Commission believes that there is little value in including such an exemption. Additionally, by including the exemption the Commission believes that unforeseen circumstances could allow for firms to take advantage of the exemption

in the future in ways that are not consistent with the original intent of the exemption, much like firms currently rely on Rule 15b9-1 in ways that are not consistent with the original intent.

2. Exchange Membership Alternative

The amendments, in accordance with Section 15(b)(8), preclude any firm that is not a member of an Association from trading on exchanges of which it is not a member.[350] Further, under the amendments, if a firm becomes a member of an Association, it would not have to become a member of each exchange upon which it trades.[351] The Commission has also considered requiring brokers and dealers to become a member of every exchange on which they trade and to become a member of an Association to trade off-exchange ("Exchange Membership Alternative").

In considering the Exchange Membership Alternative, the Commission weighed whether the same issue of off-exchange activity not being subject to effective regulatory oversight that exists when a non-FINRA member firm trades off-exchange is present when a member or non-FINRA member firm trades on an exchange of which it is not a member (through a member of that exchange). The Commission continues to believe that the amendments adequately address the issue of establishing effective oversight of off-exchange activity and that the more onerous Exchange Membership Alternative would not provide any additional regulatory benefit beyond the benefits the amendments provide for several reasons. First, while some exchanges may lack specialized regulatory personnel to directly surveil their members' trading off-exchange, FINRA

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350 The amendments provide limited exemptions for order routing to satisfy certain provisions of Regulation NMS and the Options Linkage Plan and for executing the stock leg of a stock-option order.

351 In order to trade on exchanges of which it is not a member, the firm would have to trade with or through another broker or dealer that is a member of that exchange.

has these resources to surveil the activity of member firms both on exchanges and off-exchange. Accordingly, requiring member firms to also become members of each exchange on which they effect transactions, including indirectly, would be unnecessarily duplicative because FINRA already has the resources necessary to surveil the activity of a member firm trading on an exchange of which it is not a member. In addition, while some exchanges do not have a specialized rule set to govern their members' activity in the off-exchange market, FINRA's rules are often consistent with the trading rules of exchanges on which members transact.[352] If a member firm were to violate an exchange rule on an exchange of which it is not a member, FINRA would have the jurisdiction needed to address the resulting violation. Therefore, not requiring that the member firm also become a member of that exchange would not prevent FINRA from exercising jurisdiction over the matter.

The Exchange Membership Alternative might have required firms to become members of more SROs than required under the proposed amendments, which would impose additional costs. In particular, some non-FINRA member firms that would become member firms under the proposed amendments would also need to become members of additional exchanges or cease trading on those exchanges. In addition, some current member firms would also need to become members of additional exchanges.

3. Retaining the De Minimis Allowance

The Commission considered retaining the $1,000 de minimis allowance for trading other than on an exchange of which the non-FINRA member firm is a member but removing the exception for proprietary trading conducted with or through another registered broker or dealer.

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352 See supra notes 53 - 54 and accompanying text.

As discussed above,[353] the Commission continues to believe that the magnitude of the de minimis allowance is no longer economically meaningful. Furthermore, the Commission continues to believe that the commission sharing arrangements discussed previously[354] are rarely, if ever, used.

4. Eliminate the Rule 15b9-1 Exemption

The Commission could eliminate Rule 15b9-1 altogether, leaving no exemption from Section 15(b)(8) of the Act. This would cause all current non-FINRA member firms that effect off-member-exchange securities transactions to be required by Section 15(b)(8) to join FINRA, which could improve FINRA's ability to surveil activity of member firms both on and off exchange, as well as investigate potentially violative behavior. Though, the Commission believes that such violative behavior by such firms may be easily identifiable under the proposed amendments, due to the fact that the proposed exemptions are narrow. However, eliminating the exemption for firms that would qualify for the routing exemption or the stock-option order exemption may prove to unnecessarily increase the costs for such firms. The Commission also believes that the routing exemption and stock-option order exemption will provide important avenues for providing liquidity and, therefore, eliminating the exemptions may drive these firms from the market and lead to a reduction in liquidity and market quality.

E. Request for Comment on Economic Analysis

The Commission requests comment on all aspects of this Economic Analysis, including whether the analysis has: (1) identified all benefits and costs, including all effects on efficiency,

353 See supra Section III.A.

354 Id.

competition, and capital formation; (2) given due consideration to each benefit and cost, including each effect on efficiency, competition, and capital formation; and (3) identified and considered reasonable alternatives to the proposed rule amendments. We request and encourage any interested person to submit comments regarding the proposed rules, our analysis of the potential effects of the proposed amendments, and other matters that may have an effect on the proposed rules. We request that commenters identify sources of data and information as well as provide data and information to assist us in analyzing the economic consequences of the proposed rules and proposed amendments. We also are interested in comments on the qualitative benefits and costs we have identified and any benefits and costs we may have overlooked. In addition to our general request for comments on the Economic Analysis associated with the proposed rules and proposed amendments, we request specific comment on certain aspects of the proposal:

61. *Regulatory Structure and Activity Levels of Non-FINRA Member Firms*. The Economic Analysis discusses the current landscape for non-FINRA member firms.

    - Is the Commission's description of the current activity levels of non-FINRA member firms accurate? If not, can you provide additional data to better describe non-FINRA member firms' activity levels?
    - Is there information or data on the trading activity level of non-FINRA member firms, in TRACE reportable securities other than U.S. Treasury securities? If so, please provide data.

62. *Current Market Oversight.* The Economic Analysis describes the current structure of market oversight for non-FINRA member firms:

- Is the Commission's description of current market oversight accurate? Why or why not?

63. *Effects on Regulatory Supervision*. Under the amendments, some non-FINRA member firms would be required to join an Association and be subject to additional market oversight.

- Would the proposed amendment improve regulatory oversight of current non-FINRA member firms? If not, is there currently adequate oversight of non-FINRA member firms?
- Would improved regulatory oversight improve market quality in financial markets?
- Would the proposed rules improve transparency for non-FINRA member firms that have significant trading activities in U.S. Treasury securities markets?
- Are there significant limitations, beyond those discussed above, in the economic analysis of the effect on regulatory supervision?

64. *Firm Response and Effect on Market Activity.* Under the proposed amendment, non-FINRA member firms would be required to either join an Association or change their trading practices to qualify for an exemption.

- Will some non-FINRA member firms change their business practices, including ceasing to trade securities, as opposed to joining an Association as a result of the proposed amendments? Why or why not?

- Will some non-FINRA member firms join each exchange on which they trade as opposed to joining an Association as a result of the proposed amendments? Why or why not?
- Will the proposed amendments lead to a reduction of liquidity as a result of non-FINRA member firms changing their business practices as due to the proposed amendments? Why or why not?

65. *Competitive Effects on Off-Exchange Market Regulation.* The proposed amendments may create an incentive for the creation of another Association to compete with FINRA.

- Could the proposed amendments provide a strong enough incentive for the creation of a second Association? Why or why not? Do you believe that there are barriers to entry that would prevent a second Association from being formed?

66. *Effects on Current FINRA Member Firms.* The proposed amendments are likely to have indirect effects on FINRA member firms as well.

- Would the proposed amendments create a more level regulatory playing field for FINRA member firms relative to non-FINRA member firms?

67. *Effects on Price Discovery*

- Would the proposed amendments decrease competitive advantages and reduce costs borne by the investing public through increased price discovery? Why or why not?

68. *Costs.* The proposed amendments will have several direct costs for non-FINRA member firms.

- Has the proposal accurately described the costs to non-FINRA member firms? Why or why not?
- Has the proposal accurately estimated the fees assessed by FINRA? If not, can you provide estimates?
- In 2015 FINRA proposed amendments to the TAF in response to a previous Commission proposal to amend the 15b9-1 exemption. If the proposed FINRA amendments are adopted, how would this change the economic effects?

69. *Alternatives.* The Commission listed several reasonable alternatives.

- Do you believe that the economic effects of each of the provided alternatives has been accurately described and evaluated?
- Are there other alternatives?
- How many non-FINRA members would qualify for a floor trading hedging exemption? Is zero accurate?

VII. Paperwork Reduction Act

Certain provisions of the proposed amendments to Rule 15b9-1 contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[355] As discussed in Section III.B, the proposed amendments to Rule 15b9-1, if adopted, would require brokers or dealers relying on the stock-option order exemption to establish,

[355] 44 U.S.C. 3501 et seq.

maintain, and enforce certain written policies and procedures. Compliance with these collections of information requirements would be mandatory for firms relying on the amended rule. The Commission is submitting these collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title of this new collection of information is "Rule 15b9-1 Exemptions." An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the agency displays a currently valid control number.

A. Summary of Collection of Information

The proposed amendments to Rule 15b9-1 include a collection of information within the meaning of the PRA for brokers or dealers relying on the stock-option order exemption under the amended rule. The stock-option order exemption under the amendments to Rule 15b9-1 would permit a qualifying broker or dealer to effect securities transactions otherwise than on an exchange where it is a member, with or through another broker or dealer, that are solely for the purpose of executing the stock leg of a stock-option order. Brokers or dealers relying on this exemption would be required to establish, maintain, and enforce written policies and procedures reasonably designed to ensure and demonstrate that such transactions are solely for the purpose of executing the stock leg of a stock-option order. In addition, such brokers or dealers would be required to preserve a copy of their policies and procedures in a manner consistent with Rule 17a-4 until three years after the date the policies and procedures are replaced with updated policies and procedures.

B. Proposed Use of Information

The policies and procedures required under amended Rule 15b9-1 would be used by the Commission and SROs to understand how brokers and dealers relying on the exemption evaluate

whether the securities transactions that they effect elsewhere than an exchange where they are a member are solely for the purpose of executing the stock leg of a stock-option order and, more generally, how such brokers and dealers are complying with the requirements of the exemption and Rule 15b9-1. These policies and procedures would be used generally by the Commission as part of its ongoing efforts to monitor and enforce compliance with the federal securities laws, including Section 15(b)(8) of the Act and Rule 15b9-1 thereunder. In addition, SROs may use the information to monitor and enforce compliance by their members with applicable SRO rules and the federal securities laws.

C. Respondents

The Commission believes that a small number of brokers or dealers would rely on the stock-option order exemption. The Commission estimates that, based on publicly available information reviewed covering the end of April 2022, there are approximately 65 brokers-dealers registered with the Commission that are currently a member of an exchange but not a member of an Association. The Commission believes that some, but not all, of these brokers-dealers would likely choose to avail themselves of the stock-option order exemption, because not all of them handle stock-option orders or, for those that do handle stock-option orders, they may effect the execution of stock leg components of those orders on exchanges where they are a member. The Commission estimates that seven firms could potentially rely on the stock-option order exemption and would therefore be required to comply with the policies and procedures requirement.[356] The Commission believes that some of these firms could want the ability to effect securities transactions elsewhere than an exchange where they are a member that are not

[356] See supra Section III.B.2.

for the purpose of executing the stock leg of a stock-option order, and may, accordingly, choose to join an Association as a result of the amendments to Rule 15b9-1.

D. Total Initial and Annual Reporting and Recordkeeping Burdens

The Commission estimates that the one-time, initial burden for a broker or dealer to establish written policies and procedures as required under amended Rule 15b9-1 would be approximately 8 hours.[357] This figure is based on the estimated number of hours to develop a set of written policies and procedures, including review and approval by appropriate legal personnel. The Commission notes that the policies and procedures proposed in the amended rule are limited to those transactions that are solely for the purpose of executing the stock leg of a stock-option order. In addition, the Commission estimates that the annual burden of maintaining and enforcing such policies and procedures, including a review of such policies at least annually, would be approximately 48 hours for each broker or dealer.[358] This figure includes an estimate of hours related to reviewing existing policies and procedures, making necessary updates, conducting ongoing training, maintaining relevant systems and internal controls, performing necessary testing and monitoring of stock-leg transactions as they relate to the broker's or dealer's activities and maintaining copies of the policies and procedures for the period of time required by the amended rule.

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357 This figure is based on the following: (Compliance Manager at 5 hours) + (Compliance Attorney at 2.5 hours) + (Director of Compliance at 0.5 hour) = 8 burden hours per broker or dealer.

358 This figure is based on the following: (Compliance Manager at 30 hours) + (Compliance Attorney at 12 hours) + (Director of Compliance at 6 hours) = 48 burden hours per broker or dealer.

The Commission estimates that the initial, first year burden associated with amended Rule 15b9-1 would be 56 hours per broker or dealer, which corresponds to an initial aggregate burden of 392 hours.[359] The Commission estimates that the ongoing annualized burden associated with Rule 15b9-1 would be 48 hours per broker or dealer, which corresponds to an ongoing annualized aggregate burden of 336 hours.[360]

E. Collection of Information is Mandatory

All of the collection of information discussed above would be mandatory.

F. Confidentiality of Responses to Collection of Information

To the extent that the Commission receives confidential information pursuant to the collection of information, such information will be kept confidential, subject to the provisions of applicable law.[361]

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359 This figure is based on the following: ((8 burden hours per broker or dealer) + (48 burden hours per broker or dealer)) x (7 brokers and dealers) = 392 burden hours during the first year. In estimating these burden hours, the Commission also examined the estimated initial and ongoing burden hours imposed on registered security-based swap dealers under Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information. See Exchange Act Release No. 74244 (February 11, 2015) 80 FR 14564, 14683 (March 19, 2015) ("Regulation SBSR"). Regulation SBSR requires registered security-based swap dealers to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure compliance with any security-based swap transaction reporting obligations. Id. The estimated initial and ongoing compliance burden on registered security-based swap dealers under Regulation SBSR were 216 burden hours and 120 burden hours, respectively. Id. The policies and procedures under the proposed amendments to Rule 15b9-1 are much more limited in nature.

360 This figure is based on the following: (48 burden hours per broker or dealer) x (7 brokers and dealers) = 336 ongoing, annualized aggregate burden hours.

361 See, e.g., 5 U.S.C. 552 et seq.; 15 U.S.C. 78x (governing the public availability of information obtained by the Commission).

G. Retention Period for Recordkeeping Requirements

Brokers or dealers seeking to take advantage of the stock-option order exemption would be required to preserve a copy of their policies and procedures in a manner consistent with Rule 17a-4[362] until three years after the date the policies and procedures are replaced with updated policies and procedures.

H. Request for Comments

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comment to:

70. Evaluate whether the proposed collection of information is necessary for the proper performance of our functions, including whether the information shall have practical utility;
71. Evaluate the accuracy of our estimate of the burden of the proposed collection of information;
72. Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and
73. Evaluate whether there are ways to minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

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362 17 CFR 240.17a-4. Registered brokers and dealers are already subject to existing recordkeeping and retention requirements under Rule 17a-4. However, amended Rule 15b9-1 contains a requirement that a broker or dealer relying on the stock-option order exemption preserve a copy of its policies and procedures in a manner consistent with Rule 17a-4 until three years after the date the policies and procedures are replaced with updated policies and procedures. The burdens associated with this recordkeeping obligation have been accounted for in the burden estimates discussed above for amended Rule 15b9-1.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File Number S7-05-15. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File Number S7-05-15 and be submitted to the Securities and Exchange Commission, Office of FOIA/PA Services, 100 F Street, NE, Washington, DC 20549-2736. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VIII. Consideration of Impact on Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, ("SBREFA"),[363] the Commission requests comment on the potential effect of the proposed amendments to Rule 15b9-1 on the United States economy on an annual basis. The Commission also requests comment on any potential increases in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

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363 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C., and as a note to 5 U.S.C. 601).

IX. Regulatory Flexibility Act Certification

Section 3(a) of the Regulatory Flexibility Act of 1980[364] ("RFA") requires the Commission to undertake an initial regulatory flexibility analysis of the impact of the rule amendments on small entities unless the Commission certifies that the rule would not have a significant economic impact on a substantial number of small entities.[365] For purposes of Commission rulemaking in connection with the RFA,[366] a small entity includes a broker or dealer that: (1) had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,[367] or, if not required to file such statements, a broker or dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization.[368]

The Commission examined recent FOCUS data for the 3,528 active brokers and dealers overseen by the Commission, including 3,454 brokers and dealers that are FINRA members and

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364 5 U.S.C. 603(a).

365 5 U.S.C. 605(b).

366 Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term "small entity" for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this rulemaking, are set forth in Rule 0-10 under the Exchange Act, 17 CFR 240.0-10. See Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982) (File No. AS-305).

367 17 CFR 240.17a-5(d).

368 See 17 CFR 240.0-10(c).

the 65 non-FINRA member firms as of April 2022 and estimates that not more than four of the affected entities have net capital of $500,000 or less and are not affiliates of larger organizations. The Commission oversees approximately 3,528 brokers and dealers, of which 740 have net capital of $500,000 or less and are not affiliates of larger organizations.[369] Because the Commission estimates that not more than four small entities out of 740 total small entities currently registered with the Commission would be required to become FINRA members as a result of the proposed rule changes, the Commission certifies that the proposed amendments to Rule 15b9-1 would not, if adopted, have a significant economic impact on a substantial number of small entities.[370]

Requests for Comment:

The Commission requests comment on all aspects of the foregoing certification as well as, in particular, on the following questions:

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369 Data from FOCUS for Quarter 4 of 2021.

370 One commenter to the 2015 Proposal disagreed with the Commission's certification in the 2015 Proposal and stated that the amended rule would have a significant economic impact on a substantial number of small entities. Specifically, the commenter stated that 12 options exchange member firms that were not FINRA members in reliance on current Rule 15b9-1 conduct off-exchange trading on behalf of their clients, were likely small entities, and would not be eligible for the then-proposed dealer hedging exemption. See NYSE/NASDAQ Letter at 4 and n. 5. Since the Commission no longer is including a hedging exemption in amended Rule 15b9-1, these firms could still be impacted by the amended rule. But the Commission preliminarily believes that these options exchange member firms' off-exchange trading could be stock trading in relation to their handling of stock-option orders and, therefore, these firms may be able to rely on the stock-option order exemption that the Commission is proposing today. Moreover, as noted above, the Commission now estimates that not more than four small entities would be impacted by the proposed amendments to Rule 15b9-1. As a result, the Commission believes that the proposed amendments to Rule 15b9-1 would not have a significant impact on a substantial number of small entities.

74. We solicit comment as to whether the proposed amendments could have impacts on small entities that have not been considered. We request that commenters describe the nature of any impacts on small entities and provide empirical data to support the extent of such effect, including the magnitude of any economic impact the proposed amendments would have on small entities.

75. Do commenters believe that the proposed amendments would have a significant economic impact on a substantial number of small entities? If so, how should the Commission alter the proposed amendments to lessen the impact on these entities?

Such comments will be placed in the same public file as comments on the proposed amendments to Rule 15b9-1. Persons wishing to submit written comments should refer to the instructions for submitting comments in the front of this release.

X. Statutory Authority

The Exchange Act, 15 U.S.C. 78a et seq., and particularly Sections 3, 15, 15A, 17, 19, 23, and 36 thereof.

List of Subjects in 17 CFR Part 240

Brokers, Dealers, Registration, Securities.

For the reasons set out in the preamble, the Commission proposes to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201, et seq.; and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1376 (2010); and Pub. L. 112-106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

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2. Section 240.15b9-1 is revised to read as follows:

§ 240.15b9-1 Exemption for certain exchange members.

Any broker or dealer required by section 15(b)(8) of the Act (15 U.S.C. 78o(b)(8)) to become a member of a registered national securities association shall be exempt from such requirement if it:

(a) Is a member of a national securities exchange;

(b) Carries no customer accounts; and

(c) Effects transactions in securities solely on a national securities exchange of which it is a member, except that with respect to this paragraph (c):

(1) A broker or dealer may effect transactions in securities otherwise than on a national securities exchange of which the broker or dealer is a member that result solely from orders that are routed by a national securities exchange of which the broker or dealer is a member to comply with 17 CFR 242.611 or the Options Order Protection and Locked/Crossed Market Plan; or

(2) A broker or dealer may effect transactions in securities otherwise than on a national securities exchange of which the broker or dealer is a member, with or through another registered broker or dealer, that are solely for the purpose of executing the stock leg of a stock-option order.

A broker or dealer seeking to rely on this exception shall establish, maintain and enforce written policies and procedures reasonably designed to ensure and demonstrate that such transactions are solely for the purpose of executing the stock leg of a stock-option order. Such broker or dealer shall preserve a copy of its policies and procedures in a manner consistent with 17 CFR 240.17a-4 until three years after the date the policies and procedures are replaced with updated policies and procedures.

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By the Commission.

Dated: July 29, 2022.

J. Matthew DeLesDernier,
Deputy Secretary.