

June 1, 2015

Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: Exemption for Certain Exchange Members (File No. S7-05-15)

Dear Mr. Fields:

Hudson River Trading LLC (“Hudson River Trading”) appreciates the opportunity to comment on the proposed amendments to Rule 15b9-1 (the “Proposed Rule”) which would amend the exemption of certain broker-dealers from FINRA membership. Hudson River Trading is a global, multi-asset class quantitative trading firm that develops automated trading strategies that provide liquidity and facilitate price discovery on exchanges and Alternative Trading Systems (“ATs”).

Hudson River Trading’s broker-dealer affiliate, HRT Financial LLC (“HRTF”), is a proprietary trading and market making firm that is registered with the Securities and Exchange Commission (the “Commission”) and 16 exchanges, including all US equities exchanges. HRTF is currently exempt from FINRA registration under 15b9-1. HRTF typically participates in more than 5% of US equities volume and executes more than 99% of its volume on-exchange.

Hudson River Trading believes that it is critical that regulators have access to the tools and information required to properly monitor market participants and market activity in order to ensure fair competition and investor confidence and foster well-regulated markets.

We believe that the Proposed Rule would have a small, positive impact on regulatory oversight and enforcement. It is difficult to comment on the costs associated with the Proposed Rule, as the outcome of how the FINRA Trading Activity Fee (“TAF”) is assessed will result in dramatically different outcomes for the affected firms. If FINRA’s proposal is not approved, we do not believe the marginal benefits would justify the substantial costs to the affected firms. Should FINRA’s proposal to exempt on-exchange activities of proprietary trading firms be approved, we believe the additional costs associated with the Proposed Rule would be reasonable.

## **Background**

In the Proposed Rule, the Commission notes three categories of regulation, which we will describe briefly below. For a more detailed explanation, please see pages 20-23 of the Proposed Rule.

Member Regulation – Broker-dealers have a Designated Examining Authority (“DEA”) appointed to examine exchange members’ compliance with financial responsibility requirements imposed by the Securities Exchange Act of 1934 and for examining common members with respect to common rules subject to 17d-2 agreements. Some exchanges have outsourced this activity to FINRA through Regulatory Services Agreements (“RSAs”).

Off-exchange Regulation – Refers to regulation of trading of a number of financial products not on a National Securities Exchange. FINRA, as the sole National Securities Association, is responsible for regulating off-exchange trading.

Exchange Regulation – Exchanges have a regulatory mandate with a primary responsibility to regulate trading on their respective exchanges. Many exchanges have outsourced this activity to FINRA through RSAs.

Our comments will focus on the impact of the Proposed Rule on these regulatory functions with respect to improving regulatory oversight, as well as the cost to broker-dealers affected by the Proposed Rule. We will generally address many questions posed by the Commission in the proposal and our responses to specific questions will follow below. Our comments on the impact of the Proposed Rule will be from the perspective of an active, cross-market proprietary trading firm. To avoid confusion, we will refer to current FINRA members as “Members” and current non-FINRA member broker-dealers as “Non-Members.”

## **Impact on Regulatory Oversight**

### Member Regulation

The Proposed Rule would effectively require FINRA membership for all broker-dealers that trade off-exchange. Currently, a firm that is exempt from FINRA registration is a member of an exchange that acts as its DEA<sup>12</sup>. In the Proposed Rule, the Commission does not note deficiencies with these exchanges’ oversight of Non-Members for whom they act as DEA. In fact, some exchanges outsource this function to FINRA through an RSA. The Proposed Rule would alter the current exchange DEA structure without any purported benefit to member regulation by requiring FINRA membership<sup>3</sup>. Further, to the extent there are deficiencies with any exchange DEA programs, they should be addressed individually with the exchange, rather than through a broad rule proposal. We believe that the current member regulation regime as performed by exchange DEAs is effective under current rules. We do not believe the proposal would significantly affect the quality of member regulation positively or negatively, especially when FINRA already performs the DEA function on behalf of three of four exchanges.

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<sup>1</sup> CHX, CBOE, NASDAQ OMX PHLX and NYSE ARCA act as DEA.

<sup>2</sup> CHX, NASDAQ OMX PHLX and NYSE ARCA outsource their DEA function to FINRA.

<sup>3</sup> While the Proposed Rule does not require Non-Members to have FINRA act as their DEA, it would be cost effective for Non-Members to petition to change their DEA to FINRA as FINRA’s fees do not differentiate between firms for which they act as DEA and other member firms. Other exchanges acting as DEA typically charge additional fees to firms for which they act as DEA.

### Off-exchange Regulation

The Commission notes potential gaps in FINRA's off-exchange regulatory regime due to Rule 15b9-1 exemptions. First, Members that transact off-exchange with a Non-Member are not currently required to report the identity (or MPID) of the Non-Member in OATS. The Proposed Rule notes in footnote 84 that FINRA has requested comments on this. If formally proposed and approved, this would allow FINRA to monitor the off-exchange activities of Non-Members.

Hudson River Trading supports FINRA's proposal and we believe it is an efficient and cost effective manner for FINRA to collect this data to effectively regulate the off-exchange market. Further, this data will be captured by the Consolidated Audit Trail.

The Commission also notes that even with all the data, FINRA still lacks jurisdiction over off-exchange Non-Member activity. In this regard, Non-Members are similar to many other customers of FINRA-registered broker-dealers such as hedge funds, mutual funds and individual investors that participate in off-exchange trading. However, as most activity in the interconnected US equities market is cross-market, Non-Member broker-dealers would continue to be subject to exchange jurisdiction. In any case, all off-exchange activity is subject to federal securities laws and Commission jurisdiction.

The Commission also notes that Non-Members are not required to submit OATS<sup>4</sup>. However, the Commission states in the Proposed Rule that FINRA currently captures 99.6% of US equities activity. OATS information of proprietary trading firms is generally duplicative to information already captured by FINRA through exchange and ATS data (assuming that ATSS would be required to populate the Non-Member's MPID)<sup>5</sup>. Submitting this information would add little to no value while requiring FINRA to process and store potentially large volumes of duplicative data. Further, to the extent FINRA views this data as useful in a particular situation, it is generally available upon request<sup>6</sup>.

We believe that requiring Non-Members that trade off-exchange to become FINRA members will improve oversight at the margin and make enforcement of Non-Members more efficient.

However, we believe that if FINRA requires reporting of Non-Member MPIDs (which they should do regardless of the outcome of this proposal), the benefit of the proposal on oversight will be substantially muted. Once FINRA has Non-Member MPID information, they will have a near complete picture of trading activity. As we stated, we believe there is little value in having proprietary trading firms submit OATS information that duplicates information received from

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<sup>4</sup> NASDAQ and NYSE members are required to submit OATS only upon request of FINRA on behalf of NASDAQ or NYSE.

<sup>5</sup> Non-Members submitting OATS information may help to increase the portion of market activity captured by FINRA and aid cross-market surveillance. While desirable, we believe this is better accomplished through 17d-2 agreements.

<sup>6</sup> The Commission did not note how many of the 14 active, cross-market trading firms it identified were either NASDAQ or NYSE members that must compile OATS and submit it upon request, but given their descriptions, we believe it is reasonable to assume that many are.

exchanges and ATSS<sup>7</sup>. Finally, we agree that having Non-Members registered with FINRA would make enforcement of off-exchange trading more efficient.

### Exchange Regulation

The proposed amendments would have little to no impact on exchange regulation. FINRA currently provides exchange regulation for many exchanges pursuant to RSAs and already regulates Non-Member broker-dealer activities due to its relationships with exchanges. As noted above, FINRA has access to 99.6% of trading activity data in US equities. Further, the Consolidated Audit Trail is being developed to ensure a complete view of activity across markets. There is value in regulators having access to all information in order to properly perform cross-market surveillance; however we do not believe this proposal meaningfully addresses cross-market surveillance since, while FINRA currently performs cross-market surveillance, it is not part of their mandate. We believe that cross-market surveillance is important to market integrity and should be addressed in a targeted proposal. We note that while FINRA currently performs cross-market surveillance as part of 17d-2 agreements, there is no mandate for them to do so. Further, as evidenced by the fact that they do not have access to 100% of market activity, their access to the data is dependent on cooperation and agreements with exchanges.

### **Impact on Non-Member Costs**

#### Member Regulation

Exchanges that act as DEA generally charge specific fees to exchange members for acting as DEA. Given proprietary trading firms' limited business model and the fact that they do not do business with public customers, the cost associated with examining these firms is relatively low. HRTF's DEA examinations typically cover financial responsibility rules, Regulation SHO, market access, Regulation NMS, supervision, registration of associated persons and written supervisory procedures. These exams typically have on-site and off-site component performed by the examiners, as well as manager review. In addition to examinations, our DEA performs routine monitoring of our financial health. The exchanges that act as DEA (including those that outsource to FINRA) for Non-Members currently charge fees that are approximately \$100,000 per year or less<sup>8</sup>. We believe these fees are broadly in line with the costs required to adequately regulate Non-Members' securities business. These fees are generally assessed through some combination of a Gross Revenue Assessment, per firm fee and/or a charge per Registered Representative. This cost is generally in line with or below the Commission's estimates for the FINRA's Gross Revenue Assessment for the 14 firms highlighted in the proposal. These exchanges do not, however, charge a fee similar to FINRA's Trading Activity Fee ("TAF").

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<sup>7</sup> In fact, even if Non-Members become FINRA members, we believe they should only be required to submit information that is not duplicative.

<sup>8</sup> See

[http://www.cboe.com/framed/pdf/framed.aspx?content=/publish/feeschedule/CBOEFeeSchedule.pdf&section=SEC\\_RESOURCES&title=CBOE%20Fee%20Schedule](http://www.cboe.com/framed/pdf/framed.aspx?content=/publish/feeschedule/CBOEFeeSchedule.pdf&section=SEC_RESOURCES&title=CBOE%20Fee%20Schedule), [https://www.nyse.com/publicdocs/nyse/markets/nyse-arca/NYSE\\_Arca\\_Marketplace\\_Fees.pdf](https://www.nyse.com/publicdocs/nyse/markets/nyse-arca/NYSE_Arca_Marketplace_Fees.pdf) and <http://www.chx.com/regulatory-operations/rules/>

It is important to note that a firm's trading volumes do not meaningfully contribute to the cost associated with Member Regulation. We estimate that FINRA, acting through an RSA for our DEA, dedicates resources roughly in line with the fees that we pay to our DEA. We estimate that excluding TAF, our member regulation fees will increase by less than \$50,000 per year using FINRA's member regulation fees. On the other hand, we estimate that if all of our trading (excluding trading currently eligible for an exemption) were liable for TAF, our TAF liability would be several million dollars per year.

As we stated in the introduction, over 99% of our volume is executed on-exchange and, as such, is already subject to Exchange Regulation. We believe that Non-Members should be exempt from TAF for proprietary trades on exchanges. This is not simply because they currently are not liable for TAF, but because on-exchange, proprietary trading activity is not a meaningful factor in the cost of Member Regulation. Applying TAF on all of a Non-Member's trades would not fairly allocate fees among members and would be unfairly punitive to proprietary trading firms. FINRA states in its Regulatory Notice 15-13 on TAF for proprietary trading firms "FINRA analyzed the potential application and impact of the TAF to proprietary trading firms and believes 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<sup>9</sup>." FINRA details several differences between firms with customers and firms without customers that account for the difference in cost of regulation.

In Regulatory Notice 15-13, FINRA requested comment on a proposal that would exempt proprietary trading firms' on-exchange trading activity from TAF. Hudson River Trading believes the proposal will substantially address our concerns with the cost associated with FINRA membership for Non-Members. If adopted, we believe that the cost of FINRA membership would be reasonable given the resources that Non-Members would likely consume. Further we believe that FINRA's proposal would result in a reasonable allocation of fees among members. However, it is important to note that, even without the TAF, the costs associated with FINRA membership would likely be substantially higher than the fees charged by some of the exchanges for DEA services.

In addition to the increased explicit fees, there are likely to be additional one-time and ongoing compliance costs associated with FINRA registration. Insofar as HRTF is a Nasdaq and NYSE member and has developed an OATS program, we do not view those costs as meaningful when compared to the potential impact of the TAF. However, as FINRA membership is currently tailored to broker-dealers with public customers as well as large integrated financial institutions, we expect that there will be additional regulatory burdens largely associated with FINRA membership requirements that are tailored to firms with different business models<sup>10</sup>. While these

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<sup>9</sup> See [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Notice\\_Regulatory\\_15-13.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-13.pdf)

<sup>10</sup> For example, FINRA requires all members to have a Fidelity Bond that mainly protects against the theft of customer funds or securities.

requirements may add some incremental cost, we believe they are manageable, and in any event, these costs would be dwarfed by the cost of the TAF.

While it is difficult to assign a specific cost, the Proposed Rule may be more costly over time as it will further concentrate power with FINRA. While FINRA should have economies of scale, it has little incentive to control costs and will have even less when virtually all firms are required to have FINRA membership. We believe that these risks highlight the importance of the Commission's oversight of FINRA.

### Off-exchange Regulation

The Commission notes in the release that the TAF is currently applied to off-exchange trades. In other words, Non-Member off-exchange trading does not reduce the TAF collected, it simply shifts the burden of collecting and making payment to the Member. Given FINRA's mandate to regulate the off-exchange market, we believe that charging the TAF on off-exchange trades is a reasonable approach to recovering FINRA's cost of doing so. The proposal will have the effect of requiring current Non-Members to pay TAF on off-exchange trades directly to FINRA (as opposed to the Member in trades between Members and a customer or Non-Member). Given that all off-exchange trades are already TAF liable (and it is a commercial decision of Members to pass through the TAF or not on off-exchange trades), we view the proposal as neutral when it comes to the cost of off-exchange trading.

### Exchange Regulation

We do not believe the proposal would have a direct impact on the overall cost of exchange regulation. Some exchanges outsource this activity to FINRA as part of their RSAs. These exchanges pay FINRA for performing the regulatory functions for their exchange. To be clear, FINRA member regulatory fees such as TAF do not fund exchange regulation.

The Commission notes in the Proposed Rule that exchanges have a mandate to regulate activity on their markets. Members' exchange trading activity on behalf of customers includes a dual mandate: the exchange must ensure that the activity is within the exchanges rules, while FINRA must ensure that, among other things, the Member is handling the customer's orders properly, ensure the investment is suitable, monitor for front-running and monitor execution quality. Such trades can be viewed to have an on-exchange and off-exchange component. For this reason, we believe that assessing TAF to exchange trades that are effected as a result of public customer orders is sensible.

When a Member or Non-Member executes a proprietary trade on-exchange, the trade is subject to exchange regulation. We do not believe that TAF is appropriate to be charged on such trades. It is important to note that FINRA already exempts some such trades. For example, FINRA exempts proprietary trades executed by Members in their capacity as an exchange Market Maker or Specialist as well as trades executed by floor broker Members that are also exchange members that qualify for an exemption under 15b9-1<sup>11</sup>. Further, FINRA has proposed exempting Non-

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<sup>11</sup> We believe this exemption applies to only floor brokers that qualify for the 15b9-1 exemption.

Member on-exchange activity. This demonstrates that FINRA already recognizes that such trades are not appropriate to be charged TAF.

To the extent that FINRA's proposed change to TAF is not adopted, we believe that Non-Member proprietary, on-exchange trades will incur substantial TAF fees that will neither fund the cost of regulating the Non-Members, nor the cost of exchange regulation. As these trades are on-exchange, they should not legitimately fund off-exchange regulation. The TAF on such trades would simply serve to subsidize FINRA Members at the expense of Non-Members. As such, we believe the appropriate approach is to exempt all on-exchange proprietary trades of Non-Members, as proposed by FINRA<sup>12</sup>. We believe all off-exchange trades of Members and Non-Members should be subject to TAF.

### **Responses to Specific Questions**

*27. Is the proposed routing exemption necessary and appropriate? Why or why not?*

We believe a routing exemption is necessary and appropriate as Regulation NMS effectively requires firms to access protected quotations of other exchanges and ATSS in order to trade effectively on exchanges of which they are members.

Joining all exchanges on which a Non-Member wants to trade would not necessarily provide the Non-Member access to all protected quotations. There are currently no ATSS that have a protected quotation. However, if an ATS were to display a protected quote on FINRA's ADF, absent the exemption, a Non-Member would not have access to the protected quotations without registering with FINRA. That would have the effect of requiring FINRA membership in order to access all protected quotations. We believe it is critical to allow firms that operate under the revised 15b9-1 exemption to have access to all protected quotations as the ability to trade on exchanges of which they are members is subject to their ability to access protected quotations.

*47. Do commenters agree with the Commission's analysis of the potential economic effects of the proposed amendments? Why or why not?*

We believe several aspects of the Commission's analysis of the potential economic effects of the proposed amendments are based on incorrect assumptions. The Commission assumes that competition is distorted by the current regulatory regime and that FINRA regulation is more costly and burdensome than exchange DEA regulation:

“Currently, Member Firms bear a number of costs not borne by Non-Member Firms including a number of regulatory fees and indirect costs that are assessed or imposed upon Member Firms. These costs 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 potentially could be assigned to Non-Member Firms selling securities off-exchange. There are indirect costs of disparate regulatory regimes as well. For example, Member Firms bear costs of interacting with regulators to accommodate supervision, and must comply with the rules of an Association as well as rules adopted by the Commission.”

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<sup>12</sup> We believe a better approach is to exempt all proprietary, on-exchange trades of Members and Non-Members.

We believe there are several incorrect assumptions expressed in the above statement and more generally in the competitive analysis.

The Commission does not take into consideration the differences in Members' business models as compared to those of Non-Members and assumes that differences in regulatory costs are unwarranted. Members' regulatory costs are higher because Members have different business models than Non-Members. For example, Members do business with public customers, engage in investment banking, write company research, handle customer orders, and sell variable annuities and complex financial products to customers. This requires broader and more extensive member regulation such as requiring supervision of sales practices, account opening procedures, suitability procedures, order handling, front running, and execution quality, among others<sup>13</sup>.

Further, membership fees cover both member regulation and off-exchange trading activity including business conducted with public customers. Even among Members, the cost of membership will vary dramatically based on the factors that FINRA uses to assess membership fees and the exemptions to TAF that a firm claims. In general, the costs a Member or Non-Member bear should be based on the actual cost of regulating them.

The Commission further assumes that regulatory fees such as the Section 3 fee and the TAF are higher for Members than Non-Members. It assumes that Non-Members do not pay them to Members on off-exchange trades. Section 3 fees and TAF are charged on off-exchange trades.

Simply put, Members can and do charge Non-Members pass-through fees associated with regulatory fees. To the extent that a Member does not pass them through to a Non-Member, it is a commercial agreement between them. Two Members could engage in an economically equivalent agreement. Given a Member's ability to pass through regulatory fees or to recoup them through other fees, we do not believe that a Member's requirement to remit payment on Section 3 and TAF distorts competition.

The Commission further suggests that there are disparate costs associated with regulatory regimes. It notes that Members have to bear the costs of interacting with regulators to accommodate supervision. This suggests a substantially higher burden associated with FINRA member regulation than exchange DEA regulation. HRTF is registered with the Commission and is a member of 16 exchanges, and it is subject to extensive regulatory oversight, the vast majority of it performed by FINRA on behalf of the exchanges. We anticipate certain changes in regulatory oversight would result from FINRA membership. However, we believe that an appropriate regulatory regime that recognizes proprietary trading firms' business model would result in better, more streamlined oversight and would not result in a substantially higher burden.

The Commission also notes that on-exchange competition between Members and Non-Members may be distorted due to TAF and other regulatory costs. The Commission compares the cost of Members' customer trading with the cost of Non-Members' proprietary trading. The analysis ignores the fact that on-exchange market making and specialist activities as well as activities by floor brokers that qualify for the 15b9-1 exemption are currently exempt from TAF. Further, all exchanges levy Section 3 fees on all sales. As such, a Member market maker is at no price

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<sup>13</sup> FINRA notes the significant cost difference of regulating proprietary trading firms as compared to firms with customers. See pg. 3, [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Notice\\_Regulatory\\_15-13.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-13.pdf)



disadvantage to a Non-Member market maker or liquidity provider with respect to on-exchange liquidity provision.

Contrary to the Commission's analysis, we believe that barring a change in the application of TAF, if the Proposed Rule is approved, Non-Members will be at a competitive disadvantage for on-exchange trading relative to Members as Non-Members' TAF will simply serve to subsidize and reduce the cost of regulation of Members and regulation of off-exchange trading as the fees generated by TAF would dwarf the costs associated with member regulation of Non-Members.

We believe there will be little to no effect on off-exchange trading as TAF and Section 3 fees are already charged on off-exchange trading.

*50. How would further changes to the scope of existing Regulatory Services Agreements between SROs affect regulators' ability to effectively surveil crossmarket and off-exchange trading?*

Hudson River Trading believes regulators should have access to information about all US equities trading in order to perform cross-market surveillance. Cross-market surveillance is not allocated to any individual SRO. We believe it is incumbent on the Commission to ensure a framework in which SROs adequately share information and appropriately share in the cost of cross-market surveillance. We believe those costs are appropriately funded by exchanges as regulators of their markets and FINRA as the regulator of the off-exchange market.

We do not believe the Commission should attempt to address cross-market surveillance by forcing all broker-dealers to become members of FINRA. Rather, we believe the Commission should 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. In fact, the Commission notes in the Proposed Rule that FINRA has access to 99.6% of US equities activity<sup>14</sup>. We believe it is critical to ensure that cross-market surveillance is based on all activity.

We note that the impact of such potential changes in 17d-2 agreements that may limit cross-market surveillance would not be limited to Non-Member firms. We believe such concerns are largely unrelated to the proposal. While we do not believe that all exchanges should be required to outsource their regulatory function to FINRA, we believe the Commission should ensure that any such changes ensure regulators have proper access to all relevant information. We believe this can be accomplished through 17d-2 agreements that fairly allocate the costs associated with cross-market surveillance while allowing exchanges to surveil any exchange specific rules.

*52. Are there any additional benefits that may arise from the proposed amendments? Or are there benefits described above that would not likely result from the proposed amendments? If so, please explain these benefits or lack of benefits in detail.*

To the extent that all or nearly all broker-dealers are required to have FINRA membership, it could create a standard set of membership, registration, member conduct and financial

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<sup>14</sup> We believe FINRA has access to this information through a combination of OATS data and data provided by exchanges as part of RSAs and/or 17d-2 agreements with FINRA.

responsibility rules. Standardizing these rules across exchanges would simplify compliance for firms that are members of several SROs and allow for better regulatory oversight. If adopted, the proposed amendments would not have a direct impact, but would effectively eliminate the rationale for many exchange specific requirements.

We believe these potential benefits should be weighed against the potential negatives associated with effectively having a single regulator for broker-dealers. We believe that standardization as well as cross-market surveillance should be included in a broader review of the Self-Regulatory Organization model.

*57. Would the cost of FINRA or exchange membership cause some Non-Member Firms to alter their activities in any way? If so, how would Non-Member Firms alter their business? How would these changes affect competition and market efficiency? How would these changes affect market quality?*

*58. Would the proposed amendments cause Non-Member Firms to exit the marketplace? If so, how many Non-Member Firms would elect to restrict their operations rather than become members of FINRA or one or more exchanges? How would these changes affect competition and market efficiency? How would these changes affect market quality? What would be the effect on liquidity of Non-Members Firms exiting the marketplace?*

If the cost of FINRA membership remains substantially more costly than exchange DEA services, Non-Member firms may curtail all off-exchange trading as the cost of FINRA membership, including the TAF, could exceed the profit derived from off-exchange trading.

Alternatively, some firms may withdraw their broker-dealer registration and trade as a customer of a broker-dealer. This activity would incur the TAF, but it would eliminate other membership costs and would dramatically reduce compliance costs. We believe such responses would result in less competition and would degrade market quality and regulatory oversight. Given the potential negatives of these outcomes, we believe it is important to ensure that the Proposed Rule is neither unnecessarily onerous nor overly expensive.

*62. Do commenters agree with the Commission's preliminary belief that the TAF collected by FINRA would not be expected to materially change if the proposed amendments were adopted? What would the effect of the proposed amendments be on the TAF assessed to current FINRA members? What would the effect of the proposed amendments be on the TAF assessed to Non-Member Firms that choose to become FINRA members?*

Unless FINRA changes TAF fee level or alters the exemptions, we would expect the amount of TAF collected to increase substantially. We believe the cost increase for member regulation of Non-Member would be several thousand percent and several million dollars. This increase in TAF would have the effect of either increasing FINRA's budget or subsidizing current Members at the expense of Non-Members. On the other hand, we believe that FINRA's TAF exemption proposal will have the effect of 1) dramatically reducing the liability of Non-Members and 2) better aligning regulatory costs with revenues. FINRA already exempts market maker or specialist activity on exchanges and floor brokers that qualify for the 15b9-1 exemption<sup>15</sup>. If

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<sup>15</sup> See [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=4694](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4694)

FINRA were to expand this exemption, as proposed, to include all proprietary activity of Non-Members on an exchange of which it is a member, the impact of TAF on Non-Members would be substantially mitigated.

We believe that this would be a fair application of TAF as the regulation of proprietary trades on an exchange is subject to that exchange's regulatory mandate. These trades are not part of FINRA's mandate of regulating members' public customer business or the off-exchange market.

We believe the application of TAF to Non-Members on all off-exchange transactions is logical given FINRA's mandate to regulate the off-exchange market. Under this regime, TAF will apply to all trades (on or off-exchange) resulting from public customers as well as all off-exchange trades.

### **Conclusion**

Hudson River Trading believes the Proposed Rule could have a positive impact on overall regulatory oversight. We believe the proposal would have little to no impact on off-exchange regulatory costs or exchange regulatory costs. We believe the member regulation costs of Non-Members, absent a change to TAF, would be substantial and could increase Non-Members' costs by several thousand percent and millions of dollars. To the extent that the application of TAF does not change, we view the proposal as unfairly allocating fees among members and unnecessarily burdensome to Non-Members. Hudson River Trading believes that FINRA's TAF proposal would mitigate the increase in cost of FINRA membership for Non-Members.

To the extent that TAF is altered substantially in line with FINRA's TAF proposal recommendation, we believe that the Proposed Rule is reasonable and could result in marginally better regulatory oversight without substantial additional cost. We believe 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 that may result from a single regulator.

Hudson River Trading appreciates the opportunity to submit these comments and is available to meet and discuss them with the Commission and its staff in order to respond to any questions.

Sincerely,

/s/ Adam Nunes

Adam Nunes  
Head of Business Development