October 4, 2013

Via Electronic Mail (rule-comments@sec.gov)

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. SR–FINRA–2013–036: Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change Relating to Wash Sale Transactions and FINRA Rule 5210 (Publication of Transactions and Quotations)

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the above-referenced proposed rule change filed by the Financial Industry Regulatory Authority ("FINRA") with the Securities and Exchange Commission ("Commission"). Under the proposed rule change, FINRA would add Supplementary Material .02 to FINRA Rule 5210 (Publication of Transactions and Quotations) to provide that securities transactions that result in no change in beneficial ownership generally are non-bona fide transactions and that members would have an obligation to establish reasonably designed policies and procedures to review their trading activity for, and prevent, those transactions.[2] SIFMA supports the goal of clarifying broker-dealers' obligations for transactions that unintentionally result in no change in beneficial ownership and do not involve manipulative or fraudulent intent. However, we believe FINRA should amend the focus of the proposal to require policies and procedures reasonably designed to monitor for and prevent the otherwise unintentional transactions that result in no change in beneficial ownership that constitutes a material percentage of consolidated trading volume in a subject security on a particular day. In addition, SIFMA offers more specific suggestions to tailor the proposal to address FINRA's specific concerns.

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1 The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

2 *See* Securities Exchange Act Release No. 70276 (August 28, 2013), 78 FR 54502 (September 4, 2013).

At the outset, SIFMA believes that the proposed rule change should not refer to "wash sales" but instead should refer to "self-trades". The term "wash sale" is not currently defined in the federal securities laws or FINRA rules, but the term is always used to connote trading activity effected with manipulative or fraudulent intent, not to refer to a transaction that simply results in no change in beneficial ownership. The prohibition on wash sales derives from Section 9(a)(1) of the Securities Exchange Act of 1934 ("Exchange Act"), which prohibits broker-dealers from executing trades that involve no change in beneficial ownership, but *only* where such trades are effected "[f]or the purpose of creating a false or misleading appearance of active trading in any security other than a government security, or a false or misleading appearance with respect to the market for any such security." Similarly, FINRA Rule 6140(b)(1) provides that "[n]o member shall, for the purpose of creating or inducing a false or misleading appearance of activity in a designated security or creating or inducing a false or misleading appearance with respect to the market in such security execute any transaction in such security which involves no change in the beneficial ownership thereof." Through the interpretation and enforcement of Section 9(a)(1) of the Exchange Act and FINRA Rule 6140(b)(1), wash sales are understood to be transactions that are knowingly effected with manipulative intent. FINRA acknowledges that its proposal addresses trading activity that is not manipulative or fraudulent. Accordingly, the proposed rule change should refer to "self-trades" to differentiate the activity subject to the proposal from wash sales, which are by definition manipulative and fraudulent.

As proposed, Supplementary Material .02 to FINRA Rule 5210 would require broker-dealers to have policies and procedures in place that are reasonably designed to review their trading activity for and prevent self-trades. FINRA would recognize limited exceptions from this prohibition, stating that "[t]ransactions that originate from unrelated algorithms or separate and distinct trading strategies within the same firm would generally be considered bona fide transactions. . . ., unless the transactions were undertaken for manipulative or other fraudulent purposes."[3] At the same time, however, the proposed rule states that "[a]lgorithms or trading strategies within the most discrete unit of an effective system of internal controls at a member firm are presumed to be related (*e.g.*, within an aggregation unit, or individual trading desks within an aggregation unit separated by reasonable information barriers, as applicable)."[4]

SIFMA appreciates FINRA's recognition that, in many situations, orders that originate from the same firm, but from separate or distinct trading strategies (*e.g.* separate "desks," aggregation units, or algorithms) have different – and sometimes competing – investment objectives and do not interact with each other prior to generating orders on the market.[5] In addition, SIFMA appreciates FINRA's recognition that not all self-trades can be prevented.[6] At the same time, FINRA states in its filing that self-trades have a distortive effect when they

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3 *Id.*

4 *Id.*

5 *Id.* at 54503.

6 *Id.* at 54504.

account for a material percentage of the consolidated trading volume in a security on a particular day.

With that being said, SIFMA believes that FINRA should amend its proposal to focus on the core issue identified in its proposal. More specifically, FINRA should amend the proposal to require broker-dealers to have policies and procedures in place that are reasonably designed to monitor for and prevent the occurrence of otherwise unintentional self-trades that would constitute a material percentage of consolidated trading volume in a subject security on a particular day. SIFMA believes this would focus the rule on the specific trading activity that FINRA identifies as problematic – self-trades that account for a material amount of volume. Accordingly, the policies and procedures requirement under the proposed rule change should be expressly directed at detecting and preventing the occurrence of a material amount of self-trading in a security on a particular day.[7] In addition, SIFMA requests that FINRA amend the rule text of its proposal to state explicitly that broker-dealers would be in violation of proposed Supplementary Material .02 only if they engage in a pattern or practice of otherwise unintentional self-trades that account for a material amount of volume. FINRA states in the description of its proposal that "only those firms that engage in a pattern or practice of effecting [self-trades] that result in a material percentage of the trading volume in a particular security would generally violate Rule 5210." SIFMA agrees with this approach, and believes it should be expressly codified under Rule 5210 so it is clear that firms will only be in violation of the rule where instances of self-trades occur at material percentages of volume over repeated trading days (i.e., a pattern or practice). A firm should not be in violation of the rule because of self-trades that occur on one or more isolated trading days, having detected and rectified the situation to prevent it from occurring repeatedly.

Separately, SIFMA requests that FINRA remove from its proposal the broad presumption that all algorithms and strategies within the most discrete unit of an effective system of internal controls at a member firm are related. Algorithms within a discrete unit may be completely unrelated but still effect unintentional self-trades. In the alternative, SIFMA requests clarification that the exclusion for unrelated algorithms is a non-exclusive safe harbor in which members firms may demonstrate their compliance by those means that best reflect their organization, rather than be limited to information barriers alone. In our view, firms should be permitted to articulate a specific basis for separation (in their policies or otherwise) without having to rebut an established presumption that all algorithms within a discrete unit are related.

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[7] Separately, SIFMA requests that FINRA clarify that member firms will be deemed in compliance with Rule 5210 by utilizing anti-internalization functionality, such as self-trade prevention modifiers, offered by exchanges. *See* NYSE Rule 13; *see also* NASDAQ Rule 4757(a)(4).

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SIFMA greatly appreciates the Commission's consideration of the issues raised above in connection with FINRA's proposed rule change. SIFMA would be pleased to discuss these comments in greater detail with the Commission and the Staff. If you have any questions, please contact either me (at 202-962-7383 or tlazo@sifma.org) or Timothy Cummings (at 212-313-1239 or tcummings@sifma.org).

Sincerely,

Theodore R. Lazo
Managing Director and
Associate General Counsel

cc: Mary Jo White, Chairman
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