

On November 21, 2014, FINRA filed with the Securities and Exchange Commission (“SEC” or “Commission”) SR-FINRA-2014-050, a proposed rule change to amend the FINRA Rule 6700 Series (Trade Reporting and Compliance Engine (TRACE)) to: (1) introduce a new contra-party type to identify non-member affiliates and to disseminate publicly this contra-party identifier, and (2) to require firms to further identify when transactions with non-member affiliates meet specified conditions, so that FINRA can suppress dissemination of those trades. The SEC published the proposed rule change for comment on December 5, 2014, and the comment period expired on January 2, 2015.<sup>1</sup> The SEC received two comment letters.<sup>2</sup> FINRA is filing this Partial Amendment No. 1 in response to comments and is attaching an Exhibit 4 and revised Exhibit 5.

#### “Non-member Affiliate” Contra-party Identifier

The proposed rule change would add a new contra-party identifier for transactions between a member and a non-member affiliate. This identifier would be disseminated publicly by FINRA through TRACE. Both commenters supported this aspect of FINRA’s proposal, and acknowledged that this refinement would improve the information available through TRACE. However, commenters requested additional implementation time. Specifically, commenters generally indicated that a more reasonable implementation timeframe would be a minimum of four to six months.<sup>3</sup> As described in more detail below, FINRA is amending its proposal to extend the implementation timeframe to allow for a minimum of four months following publication of the Regulatory Notice.

#### Same day/Same price Transactions with a Non-member Affiliate

The proposed rule change also would require that members further identify certain transactions with non-member affiliates that are not economically distinct and that reflect the same price as an offsetting transaction with another contra-party. Identification of such transactions would allow FINRA to suppress these trades that do not provide meaningful pricing and volume information from being disseminated, and avoid potential investor confusion as to the level of trading activity in TRACE-Eligible Securities. One commenter supported this proposed requirement while the other opposed it. The

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<sup>1</sup> See Securities Exchange Act Release No. 73762 (December 5, 2014), 79 FR 73670 (December 11, 2014) (Notice of Filing File No. SR-FINRA-2014-050) (“Proposal”).

<sup>2</sup> See Letter from Sean C. Davy, Managing Director, Securities Industry and Financial Markets Association, to Brent J. Fields, Secretary, SEC, dated December 23, 2014 (“SIFMA”) and letter from Kyle C. Wootten, Deputy Director, Thomson Reuters, to Brent J. Fields, Secretary, SEC, dated January 2, 2015 (“Thomson Reuters”).

<sup>3</sup> SIFMA stated that implementation would take four to five months. Thomson Reuters stated that a minimum of six months should be provided.

supporting comment letter acknowledged that continued dissemination of this duplicative transaction information would be undesirable, but asked that FINRA permit members to check for affiliate status at specific or periodic points in time, because the level of ownership interest in an affiliate is subject to change over time.<sup>4</sup> This commenter also requested a longer implementation timeframe. The other commenter noted that, while suppression of these trades could eliminate duplicative information, the effort required of members to implement the change would outweigh the benefit of eliminating duplication for a narrow subset of trades.<sup>5</sup>

FINRA continues to believe that identification and suppression of transactions by members with a non-member affiliate that occur within the same day, at the same price and in the same security will enhance transparency. For example, as described in the Proposal, where a member buys a security from a dealer and then sells the security to its non-member affiliate within the same day at the same price as its purchase from that dealer, then, under the Proposal, the report of the sell between the member and its non-member affiliate must reflect the non-member affiliate – principal transaction indicator, which would enable FINRA to identify and suppress this trade. Public price transparency regarding the overall transaction would continue to be made available because the preceding sell trade between the dealer and the member would continue to be disseminated. Likewise, for example, if a member buys a security from its non-member affiliate at a certain price and then sells that security to a dealer within the same day at the same price, the member would report a buy from its affiliate with the new non-member affiliate – principal transaction indicator, and this transaction would not be disseminated. However, as is the case today, public transparency regarding this overall transaction would be provided to the marketplace because the member also would report its sale to the dealer, which would be disseminated through TRACE.

As described in the Proposal, because these types of trades between the member and its non-member affiliate are not economically distinct and provide the same pricing information as the transaction between the member and the other dealer, public dissemination would not provide investors with useful information for pricing, valuation or risk evaluation purposes, and may in fact be distortive. Based on a review of TRACE data from Q2 2014 through Q4 2014, FINRA estimates that the impact of these types of duplicative transaction reports resulted in an increase of 3% in customer trade reports and an inflation in par value traded for customer trades of 6%. Thus, FINRA continues to believe that the anticipated benefits resulting from suppression would justify the changes necessary to comply with the proposed requirement.

To address some of the potential operational difficulties in identifying these trades, FINRA is amending the Proposal to clarify that, where a member does not append the non-member affiliate – principal transaction indicator to a trade report reflecting a

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<sup>4</sup> See SIFMA.

<sup>5</sup> See Thomson Reuters. This commenter stated that, if this proposed change is adopted, at least six months should be provided for implementation.

transaction with a non-member affiliate that ultimately proved to have been the initial leg of a same day, same price trade with another contra-party, the member would not be required to correct the prior trade report solely for the purpose of appending the indicator so long as the member did not reasonably expect (at the time of the initial trade report) to engage in a subsequent same day, same price transaction in the same security with another contra-party.<sup>6</sup> However, where a member appends the non-member affiliate – principal transaction indicator to a trade report reflecting a transaction with a non-member affiliate and, ultimately, does not engage in a same day, same price trade with another contra-party, the member must correct the prior trade report to remove the non-member affiliate – principal transaction indicator. The corrected trade report would then be disseminated by FINRA.

In response to comments regarding the continuing obligation to identify the universe of non-member affiliates, FINRA also is amending the proposal to permit members to comply with the non-member affiliate relationship identification requirements by conducting a periodic assessment of affiliate relationships. Specifically, new Supplementary Material .02 provides that it would be reasonable for a member to identify its non-member affiliates on a periodic basis of no less than annually, unless the member has undergone an organizational or operational restructuring that is likely to impact its prior identification of non-member affiliate relationships. FINRA believes that permitting members to perform a periodic check will substantially reduce operational burdens associated with the proposal without compromising the benefits the proposal is designed to provide.

Finally, FINRA is revising the implementation timeframe for the proposed rule change. Pursuant to this amendment, FINRA will announce the implementation date in a Regulatory Notice no later than 120 days following Commission approval, with an implementation date of no sooner than 120 days and no later than 270 days following publication of the Regulatory Notice.<sup>7</sup> This revised timeframe will allow FINRA to provide members with a minimum of four months following the issuance of the Regulatory Notice to make technological changes.

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<sup>6</sup> FINRA expects that the majority of the same day, same price trades covered by this proposal are known in advance and, in this regard, firms that regularly effect this type of trading with their non-member affiliates have requested this functionality be provided.

<sup>7</sup> Commenters also called for greater coordination regarding, and advance notice of, technological change requirements by FINRA (and changes by other regulatory bodies). FINRA notes that the market for TRACE-Eligible Securities is unique from equity and municipal securities, and those changes cannot always be coordinated; however, FINRA will continue to coordinate with other regulators, where practicable. FINRA has and will continue to work to bundle TRACE-related systems updates as much as possible.

**EXHIBIT 4**

Exhibit 4 shows the changes proposed in this Amendment No. 1, with the proposed changes in the original filing shown as if adopted. Proposed additions in this Amendment No. 1 appear underlined; proposed deletions appear in brackets.

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**6700. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)**

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**6730. Transaction Reporting**

(a) through (b) No Change.

**(c) Transaction Information To Be Reported**

Each TRACE trade report shall contain the following information:

(1) through (5) No Change.

(6) Contra-party's identifier (MPID, customer, or a non-member affiliate, as applicable);

(7) through (13) No Change.

**(d) Procedures for Reporting Price, Capacity, Volume**

(1) through (3) No Change.

**(4) Modifiers; Indicators**

Members shall append the applicable trade report modifiers or indicators as specified by FINRA to all transaction reports.

(A) through (D) No Change.

**(E) Non-member Affiliate – Principal Transaction Indicator**

If reporting a transaction with a “non-member affiliate,” as defined in Rule 6710, in which both the member and non-member affiliate act in a principal capacity, and that occurs within the same day, at the same price and in the same

security as a transaction by the member with another contra-party, select the non-member affiliate – principal transaction indicator. If a member does not reasonably expect to engage in a subsequent same day, same price transaction in the same security with another contra-party, the member is not required to append the principal transaction indicator or subsequently correct a prior trade report with its non-member affiliate solely for the purpose of appending the non-member affiliate – principal transaction indicator. If, however, a member appends the non-member affiliate – principal transaction indicator to a trade report reflecting a transaction with a non-member affiliate and, ultimately, does not engage in a same day, same price transaction in the same security with another contra-party, the member must correct the prior trade report to exclude the non-member affiliate – principal transaction indicator.

(e) through (f) No Change.

**••• Supplementary Material: -----**

**.01** No Change.

**.02** For purposes of compliance with paragraphs (c)(6) and (d)(4)(E), a member must identify those entities that would meet the definition of “non-member affiliate” at least annually.

However, where the member has undergone an organizational or operational restructuring that may impact its non-member affiliate relationships, it must promptly review and update, as necessary, its identification of non-member affiliates for purposes of this rule.

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**EXHIBIT 5**

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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**6000. QUOTATION AND TRANSACTION REPORTING FACILITIES**

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**6700. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)**

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**6710. Definitions**

The terms used in this Rule 6700 Series shall have the same meaning as those defined in the FINRA By-Laws and rules unless otherwise specified. For the purposes of this Rule 6700 Series, the following terms have the following meaning:

(a) through (dd) No Change.

(ee) “Non-member Affiliate” means a non-member entity that controls, is controlled by or is under common control with a member. For the purposes of this definition, “control,” along with any derivative thereof, means legal, beneficial, or equitable ownership, directly or indirectly, of 25 percent or more of the capital stock (or other ownership interest, if not a corporation) of any entity ordinarily having voting rights. The term “common control” means the same natural person or entity controls two or more entities.

**••• Supplementary Material: -----**

**.01** No Change.

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**6730. Transaction Reporting**

(a) through (b) No Change.

**(c) Transaction Information To Be Reported**

Each TRACE trade report shall contain the following information:

(1) through (5) No Change.

(6) Contra-party's identifier (MPID, customer, or a non-member affiliate, as applicable);

(7) through (13) No Change.

**(d) Procedures for Reporting Price, Capacity, Volume**

(1) through (3) No Change.

**(4) Modifiers; Indicators**

Members shall append the applicable trade report modifiers or indicators as specified by FINRA to all transaction reports.

(A) through (D) No Change.

**(E) Non-member Affiliate – Principal Transaction Indicator**

If reporting a transaction with a “non-member affiliate,” as defined in Rule 6710, in which both the member and non-member affiliate act in a principal capacity, and that occurs within the same day, at the same price and in the same security as a transaction by the member with another contra-party, select the non-member affiliate – principal transaction indicator. If a member does not reasonably expect to engage in a subsequent same day, same price transaction in the same security with another contra-party, the member is not required to append the principal transaction indicator or subsequently correct a prior trade report with its non-member affiliate solely for the purpose of appending the non-member affiliate – principal transaction indicator. If, however, a member appends the non-member affiliate – principal transaction indicator to a trade report reflecting a

transaction with a non-member affiliate and, ultimately, does not engage in a same day, same price transaction in the same security with another contra-party, the member must correct the prior trade report to exclude the non-member affiliate – principal transaction indicator.

(e) through (f) No Change.

••• **Supplementary Material:** -----

.01 No Change.

.02 For purposes of compliance with paragraphs (c)(6) and (d)(4)(E), a member must identify those entities that would meet the definition of “non-member affiliate” at least annually. However, where the member has undergone an organizational or operational restructuring that may impact its non-member affiliate relationships, it must promptly review and update, as necessary, its identification of non-member affiliates for purposes of this rule.

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**6750. Dissemination of Transaction Information**

(a) No Change.

**(b) Transaction Information Not Disseminated**

FINRA will not disseminate information on a transaction in a TRACE-Eligible Security that is:

(1) [Reserved] identified with the non-member affiliate – principal transaction indicator pursuant to Rule 6730(d)(4)(E);

(2) through (4) No Change.

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