



Financial Industry Regulatory Authority

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Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. SR-FINRA-2016-010 – Response to Comments

Dear Mr. Fields:

This letter responds to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) to the above-referenced rule filing, which relates to a proposed rule change to adopt Rule 4554 to require alternative trading systems (“ATs”) to submit additional order information to FINRA.¹

Background

FINRA is proposing to adopt Rule 4554 to require ATs to report additional order information to FINRA. While ATs already submit order information to FINRA that is required by the Order Audit Trail System (“OATS”) rules, there is additional order information not currently required to be reported to OATS, such as order re-pricing events (e.g., changes to an order that is pegged to the National Best Bid or Offer (“NBBO”)) and order display and reserve size information, that, if available to FINRA, would greatly enhance FINRA’s ability to perform certain order-based surveillance, including layering, quote spoofing and mid-point pricing manipulation surveillance, by enabling FINRA to more fully reconstruct an ATs’ order book. FINRA therefore is proposing to require ATs to report additional ATs-specific data elements in existing OATS reports for orders in NMS stocks.

The proposal sets forth four categories of reporting requirements: (1) data to be reported by all ATs at the time of order receipt; (2) data to be reported by all ATs at the time of order execution; (3) data to be reported by ATs that display subscriber orders; and (4) data specific to ATs that are registered as ADF Trading Centers. The first category requires ATs to report, among other things, whether the ATs displays

¹ See Securities Exchange Act Release No. 77269 (March 1, 2016), 81 FR 11851 (March 7, 2016) (SR-FINRA-2016-010) (“Proposal”).

subscriber orders outside of the ATS (other than to alternative trading system employees), and whether the order book is displayed to subscribers only, or distributed for publication in the consolidated quotation data. The second category requires ATSs to record and report both the NBBO (or relevant reference price) in effect at the time of order execution and the timestamp of when the ATS captured the effective NBBO (or relevant reference price), and to identify the market data feed used by the ATS to obtain the NBBO (or other reference price). For ATSs that are subject to the third category, the ATS must report whether the order is hidden or displayable, the display quantity, the reserve quantity, if applicable, the displayed price, and the price entered. For ATSs that are registered as ADF Trading Centers, the ADF Trading Center must report the quote identifier provided to the ADF if a change to the displayed size or price of an order resulted in a new quote being transmitted to the ADF. In addition, an ADF Trading Center would be required to provide a new quote identifier if an order held by the ADF Trading Center becomes associated with a quote identifier based on an action by the matching engine related to different order(s), (e.g., another order is cancelled making the order being held the best priced order in the matching engine).

The Commission received one comment letter in response to the proposed rule change.² FINRA's responses to that comment letter are set forth below.

1. New Order Type Information

Under the Proposal, ATSs will be required to provide FINRA with a unique identifier representing the specific order type, other than market and limit orders that have no other special handling instructions. In order for FINRA to map the identifier to a specific order type, an ATS will also be required to provide FINRA with a list of all of its order types 20 days before the ATS begins reporting information pursuant to this Rule, and any changes to its order types 20 days before such changes become effective. In the Proposal, FINRA noted that under current Rule 301(b)(2)(ii) of Regulation ATS, ATSs are required to file an amendment on Form ATS at least 20 calendar days prior to implementing a material change to the operation of the ATS.³ FINRA also noted that, under a proposed rule by the SEC that would alter the reporting requirements for ATSs that trade NMS stocks, an ATS would be required to amend its effective form at least 30 calendar days prior to the date of implementation

² See Letter from T.R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association ("SIFMA"), to Secretary, SEC, dated April 1, 2016 ("SIFMA Letter").

³ See Proposal, supra note 1; see also 17 CFR 242.301(b)(2)(ii). FINRA noted that, in the adopting release for Regulation NMS, the Commission stated that a material change to the operation of the ATS would include any change to: the operating platform of the ATSs, the types of securities traded, or the types of subscribers. See Proposal, supra note 1.

of a material change to the operations of the ATS or to the activities of the broker-dealer operator or its affiliates that are subject to disclosure on the form.⁴

In its comment letter, SIFMA states that FINRA should not use this proposal to “get ahead” of the Commission’s proposed new regulations relating to the registration and operation of ATSs. Specifically, with respect to the requirement to provide advance notice of new ATS order types and changes to existing ATS order types, SIFMA states that this regulatory requirement should come from the Commission, not through a FINRA rule change on OATS reporting.⁵ SIFMA further states that, if FINRA is determined to adopt its own order type reporting requirements on ATSs, it should engage in a separate proposed rule change to be evaluated on its own merits.⁶

FINRA notes that the order type requirement set forth in the Proposal is independent of the Commission’s proposed action with respect to order types, and that FINRA has fully explained and justified this requirement in the Proposal. The reference to the SEC’s proposal was solely for background purposes. As stated in the Proposal, this requirement will enable FINRA to map a specific order type identifier, which the Proposal requires each ATS to provide for each order (other than for market and limit order that have no special handling instructions), to a specific order type. This information will provide FINRA with the relevant information to reconstruct an ATS’s order book for surveillance purposes. In adopting the 20-day advance notice requirement, FINRA is adopting a standard that is consistent with the current reporting obligations under Regulation ATS, and that would therefore not increase the reporting burden on ATSs.

2. Requests for Clarification

a. NBBO Timestamping Requirements

The Proposal requires an ATS to report, for all orders, the NBBO (or relevant reference price) in effect at the time of order receipt and the timestamp of when the ATS captured the effective NBBO (or relevant reference price). As part of this report, the ATS must identify the market data feed it used to obtain the NBBO (or relevant reference price). In the Proposal, FINRA noted that there may be some time

⁴ See Proposal, supra note 1; see also Regulation of NMS Stock Alternative Trading Systems, Securities Exchange Act Release No. 76474 (November 18, 2015), 80 FR 80998, 81027-28 (December 28, 2015). In that release, the Commission stated that a scenario that is likely to implicate a material change to the operations of an ATS would likely include the introduction or removal of a new order type on the ATS. Id.

⁵ See SIFMA Letter at 3.

⁶ Id.

difference, however small, between the time that an ATS receives an order and places it on the order book, and the time that the ATS records the NBBO. Reporting both fields will therefore enable FINRA to ascertain if the NBBO changed between the time of order receipt and the time the ATS captured the effective NBBO.

SIFMA seeks to clarify that the Proposal does not require an ATS to report the time it actually received the NBBO.⁷ According to SIFMA, many ATS matching engines receive only the price changes in the NBBO and not volume changes. A comparison of the time of order receipt or execution to the time the NBBO was received could therefore show a significant time lag between the time of the NBBO and the order receipt or execution. SIFMA states that such a comparison could give FINRA the impression that an ATS is not regularly updating its quote for seconds or minutes at a time even though the NBBO being used is current and has not changed in price in the period between receipt of the NBBO and the order receipt or execution.⁸

FINRA clarifies that an ATS would comply with this requirement by reporting the time the ATS captured the NBBO, and not the time the ATS actually received the NBBO. FINRA believes that the time of NBBO capture should generally be equal to, or after, the time of order receipt. FINRA is requiring this information so that it may identify the NBBO that the ATS relied upon in determining the appropriate action to take with respect to an order. FINRA believes this additional information is necessary to determine if the NBBO changed between the time of order receipt as reported to OATS and the time the ATS captured the effective NBBO for use in determining how an order should be handled within the ATS.

SIFMA also states that, with regard to the proposed requirement to identify the market data feed used by the ATS to record the NBBO (or other reference price), FINRA should specify a list of market data feed types that should be used to populate the field. According to SIFMA, the best approach would be to designate general categories, such as "SIP," "direct," "hybrid," and "third party vendor."⁹ As it develops the technical specifications to implement this proposal, FINRA will consider SIFMA's suggestion in determining the best way to populate this field.

b. Counterparty Restrictions

The Proposal also requires each ATS to report, at the time of order receipt, whether there are any counter-party restrictions on an order. SIFMA seeks clarification that this is a yes/no requirement, and that ATSs would not be required to

⁷ See SIFMA Letter at 2.

⁸ Id.

⁹ See SIFMA Letter at 2.

report the specific counterparty restriction to OATS.¹⁰ FINRA clarifies that the requirement to identify any counterparty restrictions is a yes or no analysis, and that the ATS would not be required to describe the specific counterparty restriction to comply with this requirement.

c. Sequence Numbers

The Proposal also requires each ATS to report, at the time of order receipt, the sequence number assigned to the order event by the ATS's matching engine. SIFMA states that ATSs do not have a uniform system for assigning sequence numbers, as some ATSs assign sequence numbers by symbol, while other ATSs assign sequence numbers across all symbols. SIFMA also notes that some ATSs assign sequence numbers with numeric characters, while others use alphabetic characters.¹¹ According to SIFMA, a requirement that ATSs adopt a uniform method of assigning sequence numbers to report through OATS would create unnecessary operational burdens without enhancing FINRA's surveillance capabilities. SIFMA therefore seeks clarification that each ATS would report the specific sequence number (or other alphanumeric character) that the ATS's matching engine assigns, and that FINRA would not implement a uniform method of assigning sequence numbers.¹²

FINRA clarifies that it is not mandating a particular or uniform format by which ATSs must report sequence numbers in order to comply with this requirement. The purpose of the sequence number is to allow for events within a single symbol to be placed in the correct processing order in the event that two OATS reportable events are reported with identical timestamps. Requiring an ATS to report the processing sequence number as it currently exists at the ATS is sufficient to satisfy this requirement.

FINRA believes that the foregoing responds to the issues raised by the commenter. If you have any questions, please contact me at the below number.

Very truly yours,



Andrew Madar
Associate General Counsel
FINRA



¹⁰ See SIFMA Letter at 4.

¹¹ See SIFMA Letter at 4.

¹² Id.