

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-76213; File No. SR-FINRA-2015-043)

October 21, 2015

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to the Reporting of OTC Transactions in Exchange-Traded Managed Fund Shares (NextShares) to FINRA

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 15, 2015, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. FINRA has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,³ which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of the Substance of the Proposed Rule Change

FINRA is proposing to adopt Rule 6184 (Transactions in Exchange-Traded Managed Fund Shares (“NextShares”)) relating to the reporting of over-the-counter (“OTC”) transactions in exchange-traded managed fund shares, which have been approved by the SEC for listing and trading on the Nasdaq Stock Market LLC (“Nasdaq”). Exchange-traded managed fund shares are referred to under Nasdaq rules and herein as “NextShares.”

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

The text of the proposed rule change is available on FINRA's website at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background

In November 2014, the SEC approved a proposed rule change filed by Nasdaq to adopt Nasdaq Rule 5745 governing the listing and trading of NextShares.⁴ As described more fully in Nasdaq's filing, NextShares will trade in the secondary market using a new trading protocol called "NAV-Based Trading." In NAV-Based Trading, all bids, offers and execution prices will be expressed as a premium or discount (which may be zero) to the fund's next-determined net asset value per share ("NAV"), e.g., NAV-\$0.01 or NAV+\$0.01. A NextShares Fund's NAV

⁴ See Securities Exchange Act Release No. 73562 (November 7, 2014), 79 FR 68309 (November 14, 2014) (Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of File No. SR-NASDAQ-2014-020). In SR-NASDAQ-2014-020, Nasdaq used the terms "ETMF" and "ETMF Shares." On October 13, 2015, Nasdaq filed a proposed rule change to amend Nasdaq Rule 5745 to replace these terms with "NextShares Fund" and "NextShares," respectively. See SR-NASDAQ-2015-121, available at nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2015/SR-NASDAQ-2015-121.pdf.

will be determined each business day after the close of trading. All trades will be binding at the time of execution, with the transaction prices contingent upon the determination of the NAV at the end of the trading day.⁵ Pursuant to Nasdaq Rule 5745, trading in NextShares is limited to Nasdaq's Regular Market Session through 4:00 p.m.⁶

In its filing with the SEC, Nasdaq explained that, because existing order transmission and processing systems commonly used by exchanges and firms are generally not designed to accommodate pricing arrangements such as NAV-Based Trading, the prices of NextShares trades and quotes will be represented intraday using a "proxy price" format. In proxy price format, a NextShares Fund's next-determined NAV will be represented as 100.00. A premium or discount of a stated amount to the next-determined NAV will be represented by the same increment or decrement from 100, e.g., NAV-\$0.01 will be represented as 99.99, and NAV+\$0.01 will be represented as 100.01. Nasdaq will report intraday bids, offers and trades for NextShares in real-time to the consolidated tape using the proxy price format. However, the trade will not clear and settle at the price expressed in the proxy price format. After a NextShares Fund's NAV has been calculated at the end of the trading day, Nasdaq will price each trade executed on the exchange at the NAV (plus or minus any premium or discount) and will send the final pricing information to the National Securities Clearing Corporation ("NSCC") for clearance and settlement.

Under Nasdaq Rule 5745, the Intraday Indicative Value ("IIV") of a NextShares Fund is the estimated intraday value of a fund share based on current information regarding the value of

⁵ Thus, because in NAV-Based Trading, prices of executed trades are not determined until the reference NAV is calculated, buyers and sellers of NextShares will not know the final value of their purchases and sales until the end of the trading day.

⁶ As explained in SR-NASDAQ-2014-020, Nasdaq Rule 4120(b)(4) defines "Regular Market Session" as the trading session from 9:30 a.m. to 4:00 p.m. or 4:15 p.m.; NextShares will trade until 4:00 p.m.

the securities and other assets held by the fund. Nasdaq's rule requires that IIVs for each NextShares Fund be widely disseminated by one or more major market data vendors at intervals of not more than 15 minutes throughout Nasdaq's Regular Market Session.

On July 21, 2015, the SEC approved Nasdaq's filing proposing to list and trade the shares of 18 NextShares Funds, each of which is registered as an open-end investment company.⁷ Nasdaq recently announced that it has completed systems development to support the listing and trading of NextShares and will announce the exact listing and trading date soon.⁸ As noted above, it is anticipated that this date will be on or about February 1, 2016.

Proposed FINRA Rule 6184

Because NextShares are NMS stocks, FINRA, as the self-regulatory organization ("SRO") with responsibility for the OTC market, must support OTC trading in NextShares, and FINRA members that trade NextShares OTC will be required to report such transactions to FINRA. Thus, existing trade reporting requirements applicable to OTC transactions in NMS stocks will apply to OTC transactions in NextShares, including, for example, the requirement to report the trade as soon as practicable, but no later than 10 seconds, following execution.⁹

Pursuant to paragraph (a) of proposed Rule 6184, members that execute secondary market transactions in NextShares OTC must report such transactions for public dissemination or regulatory purposes to the FINRA/Nasdaq Trade Reporting Facility ("FINRA/Nasdaq TRF") or

⁷ See Securities Exchange Act Release No. 75499 (July 21, 2015), 80 FR 44406 (July 27, 2015) (Order Approving File No. SR-NASDAQ-2015-036).

⁸ See Equity Trader Alert #2015 – 144: Nasdaq Completes Proprietary Platform Development to Support NextShares ETMFs (September 14, 2015), available at www.nasdaqtrader.com/TraderNews.aspx?id=ETA2015-144. In its announcement, Nasdaq indicated that the initial product listing and introduction is subject to FINRA, DTCC and broker-dealer readiness.

⁹ See, e.g., Rules 6282(a) and 6380A(a).

the Alternative Display Facility (“ADF”) in accordance with the proposed Rule and the rules applicable to the trade reporting facility used by the reporting member.¹⁰ NYSE, as the Business Member under its TRF Limited Liability Company agreement with FINRA, has determined that the FINRA/NYSE Trade Reporting Facility will not support the reporting of these transactions at this time. In addition, pursuant to paragraph (d)(1) of proposed Rule 6184, OTC transactions in NextShares can only be designated for submission by FINRA to NSCC for clearance and settlement through the FINRA/Nasdaq TRF; otherwise, members that execute such transactions must have an alternative means of clearing (e.g., via direct Qualified Special Representative or “QSR” submission to NSCC).¹¹

Given the unique nature of NAV-Based Trading, FINRA is proposing the following specific requirements for reporting OTC transactions in NextShares to FINRA under proposed Rule 6184. First, as noted above, Nasdaq Rule 5745 limits trading in NextShares to Nasdaq’s Regular Market Session. Accordingly, pursuant to paragraph (b) of proposed Rule 6184, trades in NextShares reported with an execution time outside of Regular Market Session hours will be rejected by the FINRA trade reporting facility.

Second, pursuant to paragraph (c) of the proposed Rule, except as otherwise expressly provided, members must use the above-described proxy price format on all reports of transactions in NextShares submitted to FINRA, including all tape and non-tape reports, intraday clearing reports, as/of reports and reports of reversals.

Third, pursuant to paragraph (d)(2)(A) of the proposed Rule, members that report transactions in NextShares for submission by the FINRA/Nasdaq TRF to NSCC for clearance

¹⁰ See, e.g., the Rule 6200 and 7100 Series applicable to the ADF and the Rule 6300A and 7200A Series applicable to the FINRA/Nasdaq TRF.

¹¹ The ADF will not support the clearing of such transactions at this time.

and settlement must submit two clearing reports: (1) the member must submit a clearing report intraday in the proxy price format in accordance with paragraph (c);¹² and (2) following publication of the NextShares Fund's NAV at the end of the day, the member also must submit a "Clearing Copy" report to reflect the final NAV-based trade price, in accordance with the following requirements set forth in paragraph (d)(2)(B) of the proposed Rule.

First, the Clearing Copy report must be submitted before the close of the FINRA/Nasdaq TRF on the same day as submission of the transaction in the proxy price format to ensure that the transaction is included in NSCC's end of day processing. Second, consistent with current FINRA rules,¹³ a Clearing Copy report should only be submitted to the FINRA/Nasdaq TRF if the transaction was originally reported to the FINRA/Nasdaq TRF in the proxy price format. In other words, a member cannot report a trade for dissemination purposes to the ADF and for clearing purposes to the FINRA/Nasdaq TRF. Third, the Clearing Copy report must contain (1) the unique indicator specified by FINRA to denote a Clearing Copy report, and (2) the control number of the original trade report assigned by the FINRA/Nasdaq TRF. Such information will allow FINRA to link the Clearing Copy report to the associated trade report in the proxy price format. Fourth, members are expressly prohibited from aggregating multiple OTC transactions in NextShares in a single Clearing Copy report. In other words, members must submit a separate Clearing Copy report for each transaction originally reported in the proxy price format. Fifth, the proposed Rule clarifies that following submission of the Clearing Copy report, the member is

¹² Members must not wait until the NAV is published to submit transactions for clearing, because, as explained below and in the proposed Supplementary Material, all clearing submissions will be sent intraday to NSCC for risk management purposes.

¹³ See, e.g., Rule 7230A(i).

not required to cancel the initial clearing submission for the same transaction in the proxy price format.

Finally, pursuant to paragraph (d)(2)(C) of the proposed Rule, clearing reports for the purpose of transferring a position related to a previously executed trade, such as step-outs,¹⁴ must reflect the final NAV-based trade price, if submitted after publication of the NAV. In this instance, two clearing reports would not be required, and members would submit only a single clearing report (which would not be a Clearing Copy report) at the final trade price.

The proposed Supplementary Material provides additional guidance for members on reporting in the proxy price format, as well as the process for the submission of OTC transactions in NextShares to NSCC intraday before the final trade price is known. Specifically, in accordance with NSCC requirements, the FINRA/Nasdaq TRF will calculate the contract price of the trade based on the last published IIV and submit the transaction in real-time to NSCC for purposes of intraday risk management. The transaction will not clear and settle at the IIV-based price, but instead at the final NAV-based trade price submitted by the reporting member in accordance with paragraph (d)(2)(B) described above.

The proposed Supplementary Material also clarifies that members that clear directly at NSCC (and do not elect to have the FINRA/Nasdaq TRF submit trades on their behalf for clearance and settlement) must provide final pricing information for their executed trades to NSCC after the NAV is published, in accordance with NSCC requirements. FINRA will not do so on behalf of the member.

¹⁴ A step-out allows a member firm to allocate all or part of a client's position from a previously executed trade to the client's account at another broker-dealer. In other words, a step-out functions as a client's position transfer, rather than a trade; there is no exchange of shares and funds and no change in beneficial ownership. See, e.g., Trade Reporting FAQ 301.1, available at www.finra.org/industry/trade-reporting-faq#301.

FINRA notes that the staff discussed the proposed trade reporting requirements with two of its industry advisory committees, which generally indicated that the proposed approach to OTC trade reporting was reasonable. Committee members also acknowledged that firms would be required to make some systems changes for both trading and trade reporting purposes due to the unique nature of the NAV-Based Trading protocol. While some committee members indicated that they may not accept customer orders in NextShares due to the complexity of the product, other members felt that if there was customer demand, they would have to support trading in NextShares. However, FINRA notes that firms would not necessarily have to execute trades OTC, but could route to an exchange or another FINRA member for execution, and in that instance, would not be responsible for reporting the trade to FINRA.

As noted in Item 2 of this filing, FINRA has filed the proposed rule change for immediate effectiveness and proposes that the operative date will be the date announced by Nasdaq for commencement of listing and trading of NextShares on the Nasdaq exchange under Nasdaq rules, which is currently anticipated to be on or about February 1, 2016. FINRA believes that the FINRA/Nasdaq TRF and members alike will have sufficient time to make and test the necessary systems changes to ensure systems readiness by the operative date.¹⁵

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁶ which requires, among other things, that FINRA rules must be designed

¹⁵ FINRA notes that currently there are no participants on the ADF, and FINRA does not anticipate there being an active ADF participant by the current NextShares implementation date of February 1, 2016, given the steps and timeframes required for the on-boarding of a new ADF participant. See, e.g., Securities Exchange Act Release No. 71407 (January 27, 2014), 79 FR 5472 (January 31, 2014) (Order Approving File No. SR-FINRA-2013-031 relating to participation on the ADF).

¹⁶ 15 U.S.C. 78o-3(b)(6).

to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change is consistent with the Act because it requires that OTC transactions in NextShares, which are NMS stocks approved by the Commission, be reported to FINRA, in furtherance of FINRA's obligations as the SRO with responsibility for the OTC market. The proposed rule change will ensure that OTC transactions in NextShares are reported to FINRA in a uniform manner, consistent with current trade reporting rules applicable to OTC transactions in other NMS stocks. Among other things, the proposed rule change will ensure that trade data relating to OTC transactions in NextShares is disseminated to the consolidated tape and incorporated in FINRA's audit trail, and will facilitate the clearance and settlement of OTC transactions in NextShares.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

The proposed rule change proposes specific trade reporting requirements for OTC transactions in NextShares, which are NMS stocks that have been approved and determined by the Commission to be consistent with the requirements of the Exchange Act.¹⁷ FINRA believes that the proposed rule change will have no impact on many members. As an initial matter, on average, only several hundred firms execute and report OTC equity trades to FINRA on a regular basis.¹⁸ Many firms, including smaller firms, route their order flow to another firm, e.g., their

¹⁷ In approving SR-NASDAQ-2014-020, the Commission stated that it considered the proposed rule's impact on efficiency, competition and capital formation. See 79 FR at 68315, fn 72.

¹⁸ FINRA trade reporting rules require that for transactions between members, the "executing party" report the trade to FINRA. For transactions between a member and a

clearing firm, for execution, and as the routing firm, they do not have the trade reporting obligation. Thus, the universe of FINRA members that report OTC trades today is a small fraction of overall FINRA members.¹⁹ Moreover, members will not be required to trade in NextShares and could elect not to accept a customer order for NextShares. Alternatively, firms could route orders for NextShares to the Nasdaq exchange or another FINRA member for execution and reporting.

Nonetheless, members that choose to execute OTC transactions in NextShares will need to make systems changes to comply with the proposed amendments, including coding changes to accommodate the submission of Clearing Copy reports for firms that elect to clear through the FINRA/Nasdaq TRF. In addition, firms will need to adopt policies and procedures relating to the trading and reporting of such transactions. Firms will incur costs to implement and test these changes. While these costs may vary by firm (depending, for example, on the level of sophistication of a firm's technology and trading and reporting platforms), as noted above, firms will not be required to trade in NextShares. Therefore, each firm can determine for itself whether the costs of implementing the changes necessary to support OTC trading in NextShares are warranted. Additionally, as noted above, two of FINRA's industry advisory committees indicated that they believe the proposed trade reporting requirements are reasonable. As such,

non-member or customer, the member must report the trade. "Executing party" is defined under FINRA rules as the member that receives an order for handling or execution or is presented an order against its quote, does not subsequently re-route the order, and executes the transaction.

¹⁹ FINRA notes that in its filings, Nasdaq did not provide an estimate of the number of firms that would be likely to trade NextShares on the exchange or the anticipated trading volume in NextShares. Accordingly, FINRA has no benchmark on which to base any reasonable estimates of the likely number of FINRA members that may elect to execute OTC transactions in NextShares (and would therefore be required to report those transactions pursuant to this proposed rule change) or the likely OTC volume in these products.

FINRA does not believe that the proposed rule change would impose significant or differential costs on similarly situated firms.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act²⁰ and Rule 19b-4(f)(6) thereunder.²¹ FINRA believes that the filing is appropriately designated as “non-controversial” because the proposed rule change would adopt trade reporting requirements for OTC transactions in NextShares, which have been approved by the Commission for listing and trading on the Nasdaq exchange. FINRA believes that the proposed rule change proposes reasonable trade reporting requirements for OTC transactions in these securities and that firms would not find compliance with such requirements to be burdensome. Moreover, the proposed requirements would apply only to members that choose to trade NextShares OTC. As such, each firm can determine for itself whether the costs of implementing the changes necessary to support OTC trading in NextShares are warranted.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or

²⁰ 15 U.S.C. 78s(b)(3)(A).

²¹ 17 CFR 240.19b-4(f)(6).

otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2015-043 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-FINRA-2015-043. 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/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be 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 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal offices of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2015-043, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²²

Brent J. Fields
Secretary

²² 17 CFR 200.30-3(a)(12).