

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-78609; File No. SR-FINRA-2016-031)

August 18, 2016

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Use of the Alternative Display Facility for Trade Reporting Purpose Only

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 11, 2016, 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,<sup>3</sup> 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 Substance of the Proposed Rule Change

FINRA is proposing a proposed rule change relating to use of the Alternative Display Facility (“ADF”) by FINRA members for trade reporting purposes only.

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.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

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. The Exchange 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

On January 20, 2016, FINRA published a Trade Reporting Notice with guidance on firms’ over-the-counter (“OTC”) equity trade reporting obligations in the event of a systems issue during the trading day that prevents them from reporting OTC trades in NMS stocks in accordance with FINRA rules.<sup>4</sup> As set forth in the Notice, a firm that routinely reports its OTC trades in NMS stocks to only one FINRA trade reporting facility (a firm’s “primary facility”) must establish and maintain connectivity and report to a second FINRA trade reporting facility (a firm’s “secondary facility”), if the firm intends to continue to support OTC trading as an executing broker while its primary facility is experiencing a widespread systems issue.<sup>5</sup> FINRA

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<sup>4</sup> See Trade Reporting Notice, January 20, 2016 (OTC Equity Trading and Reporting in the Event of Systems Issues).

<sup>5</sup> As discussed in the Notice, if a firm chooses not to have connectivity to a secondary facility, it should cease executing OTC trades altogether when its primary trade reporting facility is experiencing a widespread systems issue. In that instance, the firm could route orders for execution to an exchange or another FINRA member (i.e., a member with connectivity and the ability to report to a FINRA trade reporting facility that is operational).

currently has three facilities that support member reporting of OTC trades in NMS stocks, as defined in SEC Rule 600(b) of Regulation NMS: the ADF and two Trade Reporting Facilities (“TRFs”). The TRFs are facilities that are operated by both FINRA and its exchange partners (NASDAQ and NYSE).

Since publication of the Trade Reporting Notice, a number of firms have inquired about using the ADF as their secondary facility for trade reporting, and at least one has inquired about using the ADF as its primary facility. While the ADF historically has not been used by members for trade reporting without quoting activity, there is nothing in the ADF rules<sup>6</sup> to prohibit it. Thus, to better accommodate firms in their efforts to comply with the guidance in the Trade Reporting Notice, and to provide an alternative to connecting to both TRFs, FINRA will make the ADF available to members for trade reporting purposes only.<sup>7</sup> FINRA currently is making systems updates to the ADF and anticipates that the ADF will be available to members before the end of this year.<sup>8</sup> Members that use the ADF for trade reporting purposes only would not be able to quote on the ADF without registering under one of the two categories of “ADF Market

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<sup>6</sup> See Rule 6200 and 7100 Series.

<sup>7</sup> While members will have the option of using the ADF as their primary facility for trade reporting, FINRA anticipates that members would be more likely to use the ADF as their secondary facility. FINRA has historically operated the ADF as a utility and has not attempted to actively attract participants in the OTC trade reporting space. For example, FINRA does not offer a market data revenue share program for the ADF comparable to the TRFs. See Rules 7610A and 7610B.

<sup>8</sup> FINRA notes that in addition to the systems updates that will be completed this year, the ADF may need additional infrastructure enhancements to support significant trade reporting volume. However, the necessary enhancements, and the time it may take to make those enhancements, will not be known until FINRA has a more concrete understanding of the level of firms’ interest in using the ADF for trade reporting purposes only and their potential volume.

Participant” under current ADF rules (i.e., Registered Reporting ADF ECN and Registered Reporting ADF Market Maker) and satisfying all applicable requirements for quoting.<sup>9</sup>

Because the substantive trade reporting and trade reporting participation requirements under current ADF rules are consistent with the trade reporting and participation requirements applicable to the TRFs,<sup>10</sup> significant rulemaking is not needed to enable firms to use the ADF for trade reporting purposes only. However, FINRA is proposing the following additional requirements that would apply specifically to members that use the ADF for trade reporting purposes only.

#### Proposed Testing Requirements

FINRA is proposing to adopt new paragraph (b)(2)(E) of Rule 7120 (Trade Reporting Participation Requirements) to require members that intend to use the ADF for trade reporting purposes only and connect to the ADF via a Financial Information eXchange (“FIX”) line to participate in annual connectivity and capacity/stress testing. Members that use only the web browser for trade reporting to the ADF and do not have any FIX connections would not be required to participate in connectivity and capacity/stress testing.<sup>11</sup>

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<sup>9</sup> For example, in addition to registration, FINRA rules include certification and deposit requirements for ADF quoting participants, as well as capacity fees and penalties. See, e.g., Rules 6271 and 7580.

<sup>10</sup> See, e.g., Rules 6282 and 7120; 6380A and 7220A; and 6380B and 7220B.

<sup>11</sup> FINRA notes that members using a web browser for trade reporting generally have relatively low volume, since it would be difficult for a member with significant volume to meet its 10-second trade reporting obligation under FINRA rules. Thus, FINRA expects that members using the web browser for trade reporting to the ADF will not put the same demands on the ADF system as firms reporting more significant volume using a FIX connection. As such, FINRA does not believe that it is necessary to require web browser users to participate in annual testing.

FINRA is proposing to waive the testing requirements under Rule 7120(b)(2)(E) for members that meet certain thresholds. Specifically, members that report at least 100 trades per month to the ADF would not be required to participate in annual connectivity testing. Thus, a member that elects to use the ADF as its primary trade reporting facility likely would be excluded from this requirement. In addition, FINRA is proposing that members would not be required to participate in annual capacity/stress testing unless their actual ADF activity levels or their capacity projections based on their TRF usage<sup>12</sup> increase by more than 20% from one year to the next. FINRA notes that the proposed waivers would apply independently. For example, a member may be subject to annual connectivity testing (because it reports fewer than 100 trades per month to the ADF), while being excused from the capacity/stress testing requirement (because its capacity projection based on its TRF usage has not increased by more than 20% from the prior year).

Pursuant to proposed Rule 7120(b)(2)(E), members that are required to participate in annual connectivity and capacity/stress testing will not be charged fees under current Rule 7530(c) for the annual testing. However, members that request additional testing beyond the required annual connectivity and capacity/stress testing would be required to pay fees for testing services under Rule 7530(c).<sup>13</sup>

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<sup>12</sup> FINRA will develop capacity projections for members that will use the ADF for trade reporting purposes only based on their current usage of a TRF, and members may be asked to review and confirm these projections from time to time. If a member's volume on a TRF increases by more than 20% from one year to the next, the member would be required to participate in capacity/stress testing to retain connectivity to the ADF for use as a secondary facility for trade reporting.

<sup>13</sup> Pursuant to Rule 7530(c)(1), members are charged \$333 per hour for testing with the ADF, subject to the exceptions identified in paragraph (c)(2) of the Rule.

FINRA believes that the proposed testing requirements will help ensure that the ADF has sufficient capability and capacity to support trade reporting, particularly in the event that members relying on the ADF as their secondary facility for trade reporting must report to the ADF in response to a widespread systems issue in their primary facility.

#### Proposed FIX Connectivity Fee

FINRA is proposing to charge members that use the ADF for trade reporting purposes only and connect to the ADF via a FIX line a monthly fee of \$500. The proposed fee would apply to all members that use the ADF for trade reporting purposes only (as either their primary or secondary facility for trade reporting).<sup>14</sup>

The proposed fee would replace the fees for ADF terminal software and servers under current Rule 7520 (Equipment Related Charges).<sup>15</sup> These fees are obsolete, as members no longer use workstations to connect to the ADF, but instead, connect via FIX or web browser. Members that elect to trade report to the ADF via web browser would pay the monthly fee of \$20 per user ID under current Rule 7510(c), rather than the proposed monthly fee for FIX connectivity.<sup>16</sup>

The proposed FIX connectivity fee would help cover the costs associated with maintaining the ADF platform and ensuring that there is sufficient capacity on the platform and

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<sup>14</sup> FINRA notes that the proposed fee would be in addition to any charges firms must pay NASDAQ, as FINRA's technology provider for the ADF, under NASDAQ rules. For example, firms that report to the ADF via FIX—either directly or indirectly through third party intermediaries (e.g., service bureaus)—would pay NASDAQ charges associated with FIX ports to connect to the ADF data center. See, e.g., NASDAQ Rule 7015.

<sup>15</sup> Pursuant to this rule, the charge for ADF terminal software is \$275 a month per terminal and \$550 a month for each server.

<sup>16</sup> Members that submit trades to the ADF, via FIX or web browser, also would be subject to the trade reporting fees under current Rule 7510(a), which fees are assessed on a per reported transaction basis.

at the securities information processors to accommodate trade reporting, particularly in the event that firms relying on the ADF as their secondary facility for trade reporting must report to the ADF in response to a widespread systems issue in their primary facility.

#### Technical Conforming Changes

FINRA is proposing the following technical conforming changes to the ADF rules.

First, FINRA is proposing to amend and rename Rule 6170 (Primary and Additional MPIDs for Alternative Display Facility Participants). With the exception of paragraphs (d) and (e), Rule 6170 relating to the use of multiple market participant identifiers (“MPIDs”) currently is limited to ADF quoting participants. FINRA is proposing to amend the Rule, as applicable, to also apply to members that use the ADF for trade reporting purposes only. In addition, FINRA is proposing to streamline and conform the Rule to Rule 6160 (Multiple MPIDs for Trade Reporting Facility Participants). The standards and processes applicable to the assignment and use of multiple MPIDs are the same for ADF and TRF participants, and as such, FINRA believes that the rules should be identical, to the extent possible.

As amended, paragraph (b) of Rule 6170 would provide that any ADF participant (which would include a member that uses the ADF for trade reporting only) that is required to obtain, or otherwise wishes to use, more than one MPID for purposes of displaying quotes/orders or reporting trades to the ADF must submit a written request, in the form required by FINRA, to, and obtain approval from, FINRA Market Operations for such additional MPID(s). As amended, this paragraph would conform to the language of current Rule 6160(a). Paragraph (c) of Rule 6170, which currently applies only to Registered Reporting ADF ECNs, would be amended to apply to “ADF Market Participants” (which term encompasses both categories of ADF quoting

participant, i.e., Registered Reporting ADF ECNs as well as Registered Reporting ADF Market Makers) and to conform to the language of Rule 6160(b).

FINRA also is proposing to amend and reorganize the Supplementary Material under Rule 6170 to conform to Rule 6160 and to delete unnecessary, and in places repetitive, language regarding the specifics of assigning “Primary” and “Additional” MPIDs. As amended, Rule 6170.01 would apply to any ADF participant (which would include a member that uses the ADF for trade reporting purposes only) and provide that an ADF participant must identify the purpose(s) and system(s) for which the multiple MPIDs will be used. If FINRA determines that the use of multiple MPIDs is detrimental to the marketplace, or that an ADF participant is using one or more additional MPIDs improperly or for other than the purpose(s) identified by the member, FINRA staff retains full discretion to limit or withdraw its grant of the additional MPID(s) to such ADF participant for purposes of displaying quotes/orders or reporting trades through the ADF. This language incorporates language in current Rule 6170.01 and .05 and conforms to the language of Rule 6160.01.

Amended Rule 6170.02 would continue to provide that each MPID belonging to a Registered Reporting ADF ECN is subject to the requirements of Rule 6279 (Alternative Trading Systems). Rule 6170.03 would be amended to apply to “ADF Market Participants,” which would encompass both categories of ADF quoting participant, and provide that if an ADF Market Participant no longer fulfills the conditions appurtenant to one of its MPIDs (e.g., by being placed into an unexcused withdrawal), it may not use another MPID for any purpose in that security. Rules 6170.04 and .05 would be deleted in their entirety.<sup>17</sup>

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<sup>17</sup> FINRA notes that as amended, Rule 6170.02 and .03 apply to quoting activity, and specifically to Registered Reporting ADF ECNs and ADF Market Participants, respectively, and thus do not correspond to any provisions of Rule 6160. FINRA further



Second, FINRA is proposing to amend paragraph (c)(1) of Rule 7510 (System Related Fees) to clarify that the web browser fee of \$20 per month per user ID will apply to all ADF participants, including members that use the ADF for trade reporting purposes only. The provision currently applies only to “ADF Market Participants,” which term is defined as a Registered Reporting ADF Market Maker or a Registered Reporting ADF ECN.

Finally, FINRA is proposing to delete paragraph (a)(9) of Rule 6220. The term “Non-Registered Reporting Member” is not used in the ADF rule set and as such should no longer be included in the definitions under Rule 6220.

FINRA has filed the proposed rule change for immediate effectiveness and the operative date will be 30 days from the date of filing.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>18</sup> which requires, among other things, that FINRA rules must be designed 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 provides members with an alternative for meeting their trade reporting obligations under FINRA rules and will allow members that wish to connect to a secondary facility for trade reporting in accordance with the

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notes that Rule 6160.02 applies exclusively to the TRFs and thus there is no corresponding provision in Rule 6170. Otherwise, Rule 6160 and 6170 are substantively identical, differing only with respect to the defined terms used or to reflect the fact that the TRFs are used for trade reporting only and the ADF could be used for both quoting and trade reporting.

<sup>18</sup> 15 U.S.C. 78o-3(b)(6).

Trade Reporting Notice to continue executing OTC trades in NMS stocks in the event their primary facility is experiencing a widespread systems issue.

In addition, FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(5) of the Act,<sup>19</sup> which requires, among other things, that FINRA rules provide for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system that FINRA operates or controls. FINRA believes that the proposed rule change to apply the web browser fee under Rule 7510(c)(1) and the proposed FIX connectivity fee under Rule 7520 for members that use the ADF for trade reporting purposes only are reasonable in light of FINRA's regulatory and operational costs, including personnel, infrastructure and technology costs. FINRA further believes that the proposed fees are equitably allocated and not unfairly discriminatory because they will apply uniformly to all similarly situated members (i.e., the web browser fee will apply uniformly to all members that elect to use the web browser and the FIX connectivity fee will apply uniformly to all members that elect to connect to the ADF via FIX for trade reporting purposes only).

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.

Economic Impact Analysis

As an initial matter, the Trade Reporting Notice applies only to members that have the trade reporting obligation under FINRA rules.<sup>20</sup> Today, on average, several hundred firms

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<sup>19</sup> 15 U.S.C. 78o-3(b)(5).

<sup>20</sup> FINRA rules for reporting OTC transactions in equity securities require that for transactions between members, the "executing party" report the trade to a FINRA facility.

execute and report OTC trades in NMS stocks to the TRFs on a regular basis. Many firms, including smaller firms, route their order flow to another firm, e.g., their clearing firm, for execution, and as the routing firm, they do not have the trade reporting obligation. Thus, the proposed rule change will have no impact on many members.

Moreover, members are not required to use the ADF for purposes of meeting their trade reporting obligations under FINRA rules. As noted above, the ADF would simply be another option available to members for trade reporting, particularly those members that elect to connect to a secondary facility in accordance with the Trade Reporting Notice. Members that determine that the ADF is not a cost-effective option for them (as either a primary or secondary facility for trade reporting) can elect to use one (or both) of the TRFs.

FINRA further notes that the proposed rule change does not create any new trade reporting obligations to members; rather it is designed to provide an alternative for members to meet their existing equity trade reporting obligations. Members that choose to rely upon the ADF as their primary or secondary facility for trade reporting will incur some costs. Members connecting to the ADF will incur a cost of \$500 per month per FIX connection or \$20 per month per user for web browser access. FINRA believes that members that report via FIX will also likely maintain at least one web user ID. Members reporting via FIX will also incur a NASDAQ charge of \$575 per port per month. Members that report trades through the ADF will be assessed charges based upon the existing fee schedule, as detailed in Rule 7510(a).

In addition, members maintaining FIX connectivity to the ADF for trade reporting purposes only will be required to conduct annual testing. The connectivity testing requirement

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For transactions between a member and a 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. See, e.g., Rule 6282(b).

will be waived for members reporting at least 100 trades per month through the ADF and the capacity/stress testing requirement will be waived for members with reported trading activity that does not increase by more than 20% from the previous year.

By providing an alternative for trade reporting, FINRA is increasing the choices available to members. FINRA anticipates that few members will use the ADF for trade reporting purposes, but this may change as the relative costs for trade reporting services shift. If a member chooses to use the ADF as a primary or secondary trade reporting venue, it will be because it is determined to be advantageous to that member.

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 Act<sup>21</sup> and Rule 19b-4(f)(6) thereunder.<sup>22</sup> FINRA believes that the filing is appropriately designated as “non-controversial” because the proposed rule change does not create any new trade reporting obligations to members, but rather provides another alternative for members to meet their existing equity trade reporting obligations. Members that do not wish to be subject to the proposed testing requirements and fees or otherwise determine that the ADF is not a cost-effective option for them—as either a primary or secondary facility for trade reporting—can

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<sup>21</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>22</sup> 17 CFR 240.19b-4(f)(6).

elect to use one (or both) of the TRFs to fulfill their trade reporting obligations under FINRA rules.

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 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](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2016-031 on the subject line.

##### Paper comments:

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

All submissions should refer to File Number SR-FINRA-2016-031. 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, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. 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-2016-031 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.<sup>23</sup>

Robert W. Errett  
Deputy Secretary

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<sup>23</sup> 17 CFR 200.30-3(a)(12).