

Regulatory Notice

14-51

Equity Trading Initiatives: OATS and ATS Reporting Requirements

FINRA Requests Comment on Proposed FINRA Rules Requiring the Identification of Non-Member Broker-Dealers in Order Audit Trail System (OATS) Reports and the Reporting of Additional Order Information by Alternative Trading Systems (ATS)

Comment Period Expires: January 13, 2015

Executive Summary

FINRA is requesting comment on proposed amendments to the OATS rules that would require member firms to report additional information to OATS. Specifically, FINRA is proposing to amend the OATS rules to require members to identify non-member broker-dealers when reporting orders received from such entities. FINRA is also proposing to require ATSS to provide FINRA with additional order book information using existing OATS interfaces.

The text of the proposed rules is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- ▶ Shelly Bohlin, Vice President, Market Analysis and Audit Trail Group, Market Regulation, at (240) 386-5029; or
- ▶ Andrew Madar, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8056.

November 2014

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Senior Management
- ▶ Trading

Key Topics

- ▶ Alternative Trading Systems
- ▶ Non-Member Broker-Dealers
- ▶ OATS

Referenced Rules & Notices

- ▶ FINRA Rule 6250
- ▶ FINRA Rule 7440
- ▶ SEA Rule 15c3-5
- ▶ SEA Rule 301
- ▶ SEA Rule 302
- ▶ SEA Rule 613

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by January 13, 2015.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to pubcom@finra.org; or
- ▶ Mailing comments in hard copy to:
Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.¹

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).²

Background and Discussion

The proposals set forth in this *Notice* are two of seven FINRA initiatives relating to equity market structure and automated trading activities including high frequency trading (HFT).³ These initiatives are designed to increase the scope of trading information FINRA receives, provide more transparency into trading activities to market participants and investors and require firms engaged in electronic trading and their employees to be trained, educated and accountable for their role in equity trading. The first proposal would require FINRA members (Reporting Members) that are reporting an order received from a broker-dealer that is not a FINRA member (non-member broker-dealer) to identify the non-member broker-dealer as part of their OATS report. The second proposal would require ATs to report additional information related to orders received by the ATS using existing OATS interfaces.

Identification of Non-Member Broker-Dealers to OATS

FINRA is proposing to require a Reporting Member that is reporting an order received from a non-member broker-dealer to identify the non-member broker-dealer as part of their OATS report. Currently, through the use of OATS and data provided to FINRA by exchanges, FINRA is able to identify with specificity the activity of FINRA member broker-dealers across market centers. However, FINRA cannot identify with specificity non-member broker-dealer activity in the over-the-counter market (OTC), or non-member broker-dealer sponsored access activity, since Reporting Members are not required to report non-member broker-dealers' identities to OATS.⁴ Consequently, FINRA is not able to consistently identify non-member broker-dealer activity and therefore cannot see a complete view of such activities conducted through FINRA members.

Although Reporting Members report orders they receive from non-member broker-dealers, these reports do not contain the identity of the non-member broker-dealer from which the order was received. Under the proposal, FINRA members receiving orders from non-member broker-dealers would be required to identify the non-member broker-dealer in their OATS reports.⁵ Members would identify the non-member broker-dealer by including a unique non-member identifier on the OATS report that will allow FINRA to obtain the identity of the non-member broker-dealer. This identifier would either be an existing SRO-assigned identifier such as a market participant identifier (MPID), or if a non-member broker-dealer does not have an SRO-assigned identifier that is available to FINRA, the Central Registration Depository (CRD) number of the non-member broker-dealer.⁶

FINRA believes that this proposal will significantly improve its ability to support cross-market surveillance and monitor OTC trading by specifically identifying broker-dealers responsible for order activity. FINRA members receive a substantial amount of order flow from non-member broker-dealers, particularly in connection with ATS and sponsored access activity,⁷ and this proposal will enable FINRA to identify and aggregate on an automated basis when a FINRA member's activities involve non-member broker-dealer activities.⁸ In addition, this additional information will allow FINRA to more readily detect potentially violative trading activity by those entities for potential enforcement action or referral to appropriate regulatory authorities as well as enable FINRA to more effectively determine whether members are complying with their regulatory obligations, including, for example, the implementation of effective risk management controls under SEA Rule 15c3-5.⁹ This requirement may also reduce the number of false alerts generated by surveillance patterns when non-member broker-dealer activity is included in surveillance information by permitting surveillance patterns to more accurately account for the specific broker-dealer that is responsible for the activity.

FINRA recognizes that this proposal will require firms to obtain and submit a unique identifier when submitting an OATS report for an order received from a non-member broker-dealer. FINRA notes, however, that unique identifiers currently exist for non-member broker-dealers, and are generally readily obtainable by the member firm trading with the non-member broker-dealer. FINRA also notes that some members already provide non-member broker-dealer identifiers for orders received from non-member broker-dealers.¹⁰ For these reasons, FINRA preliminarily believes that this proposal will not have a significant impact on Reporting Members or their reporting practices, but is soliciting comment on the impact of this proposal on Reporting Members.

Reporting of Additional Order Information by ATSS

ATSS currently submit order information relating to activity occurring on or through the ATS to FINRA through OATS.¹¹ However, there are several data elements that are not required to be reported to OATS, such as order re-pricing events (*e.g.*, an order that is pegged to the National Best Bid or Offer) and order display and reserve size. Because these components of, or changes to, an ATSS order book are not reported, FINRA is not able to use existing OATS data to fully reconstruct an ATS order book for surveillance purposes. Obtaining this additional information from ATSS would allow FINRA to use information in automated surveillance of ATSS, including trading manipulation surveillance.¹²

To enhance its ability to surveil ATS activity on an automated basis, FINRA is proposing to require ATSS that exceed a certain volume threshold to report additional order information in a manner that will supplement and link to the information currently reported by an ATS to OATS. Rather than requiring ATSS to establish a separate reporting structure for this new data, it would be reported to FINRA using existing OATS interfaces, which FINRA believes will minimize any potential duplicative reporting.¹³

The order reporting requirements would apply to any ATS (whether considered a “lit” ATS or a “dark pool”)¹⁴ that accounts for more than 0.25 percent of consolidated market share in any security over a one-month period.¹⁵ Once an ATS has exceeded the threshold for one security, it would be required to report order information for all securities for which the ATS receives an order. An ATS that has triggered the reporting requirement would have to fall under the 0.25 percent threshold and remain there for six months before being relieved of its reporting obligation.

Under the proposal, ATSS exceeding the volume requirement would be required to report all events and order attributes that would change the ATS’s system quantity (the number of shares of an order, whether displayed or undisplayed, that can currently execute within the ATS), the displayed quantity, the highest (buy orders) or lowest (sell orders) price at which the order can currently execute within the ATS, and the displayed price for an order. An ATS also would provide, for every order, the ATS book sequence identifier and the associated OATS identifier, which will link information about that order to the related information and full lifecycle reported to OATS.¹⁶

FINRA believes that this proposal will greatly enhance its ability to surveil activity occurring within an ATS, and by extension HFT and algorithmic trading activity more generally across markets. Among other things, the additional information provided under the proposal will enable FINRA to more effectively conduct automated surveillance involving ATSs, and to detect market-specific and cross-market manipulative activities. Given the significant role of ATSs in the current market structure, FINRA believes the proposed additional information will greatly enhance its ability to monitor and reconstruct trading activities occurring on or through an ATS.¹⁷

FINRA recognizes that the proposal may create or increase costs related to technological capabilities or system enhancements for reporting and compliance for members that are ATSs or that operate ATSs that exceed the volume thresholds noted above. These members will have to transmit additional order information to FINRA on a daily basis. Consequently, FINRA is soliciting comment on the impact of this proposal on members as well as on whether other approaches to obtaining ATS order book information exist, and the benefits and economic impact of such approaches.

Request for Comments

FINRA seeks comments on the proposals outlined above. In addition to general comments, FINRA specifically requests comments on the following questions:

Identification of Non-Member Broker-Dealers to OATS

- ▶ What kinds of costs would Reporting Members incur in complying with the proposed requirement to report the identity of non-member broker-dealers when receiving orders from such entities? Would these costs differ based on the member's business model? Please provide any estimates of these costs and associated assumptions underlying the estimates.
- ▶ Are there alternative methods or approaches that would provide FINRA with this same type of information? What are the economic impacts associated with these alternatives?
- ▶ What is the process by which a member firm obtains the identifier of a non-member broker-dealer? Would FINRA need to provide additional tools or information to Reporting Members in order for them to comply with the requirement?
- ▶ What other impacts would this proposal have on Reporting Members?

Reporting of Additional Order Information by ATSS

- ▶ What are the potential impacts on members of the proposal to require the reporting of ATS order book information? What kinds of costs would members incur in connection with this proposal? Do these costs differ depending on the member's business model? Please provide any estimates of these costs and associated assumptions underlying the estimates.
- ▶ In reporting ATS order book information, would members be required to generate new order information? To the extent that members will be required to code and transmit ATS order book information pursuant to FINRA OATS specifications, what impact will this have on members?
- ▶ Should the proposal require the reporting of all ATS order book information, or is there a benefit to excluding lower-volume ATSS from the reporting requirement? Is the proposed volume threshold an appropriate measure or should the volume threshold be higher or lower? Are there alternative threshold measures that FINRA should consider? What are the economic impacts associated with different volume thresholds?
- ▶ Would other approaches to reporting ATS order book information provide FINRA with comparable information? To the extent that other alternatives exist, what are the benefits, shortcomings and economic impacts of such approaches?
- ▶ Instead of submitting ATS order book information through the existing OATS gateway, are there other approaches that should be considered? What are the benefits, shortcomings and economic impacts of such approaches?

FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible.

Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
2. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the Federal Register. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.
3. *See* FINRA September 19, 2014 news release ["FINRA Board Approves Series of Equity Trading and Fixed Income Rulemaking Items."](#)
4. A FINRA member that provides sponsored access to a non-member broker-dealer has an OATS reporting obligation for each order sent to a national securities exchange pursuant to any such agreement. In this scenario, the FINRA member must report a New Order and a Route Report to the applicable exchange reflecting that the order was received from a non-member broker-dealer. *See* OATS FAQ C77.
5. FINRA Rule 7440(c)(6) requires that, for orders routed from a member to a non-member broker-dealer, the identity of that non-member broker-dealer be reported. Currently, the OATS Technical Reporting Specifications require a specific identifier for each national securities exchange to which an order is routed be reported to OATS. However, only a generic identifier for non-members other than a national securities exchange is required. Consequently, the identity of the specific non-member broker-dealer to which an order is routed is not captured. The OATS Reporting Technical Specifications will be updated to require a member to provide either an SRO-assigned identifier or CRD number when routing an order to a non-member broker-dealer.
6. Currently, all SEC-registered broker-dealers have an SRO-assigned identifier that is available to FINRA.
7. For example, in the second quarter of 2014, more than 39 percent of new orders reported to OATS were reported as being received from a non-member broker-dealer. Of particular note, more than 49 percent of ATS orders and more than 63 percent of sponsored access orders were received from a non-member broker-dealer.
8. For example, FINRA would be able to identify potential wash trades of a non-member broker-dealer, even if executed through two separate members.
9. *See* 17 CFR 240.15c3-5.
10. In the second quarter of 2014, ATSS reported the MPIDs of 19 non-FINRA member broker-dealers that submitted approximately 10.1 billion orders to those ATSS.
11. An ATS is a system that meets the statutory definition of a national securities exchange, which includes a system that brings together buyers and sellers of securities, but that elects to register as a broker-dealer and be subject to the requirements set forth in Regulation ATS.
12. FINRA already receives these data elements in the order book information provided to FINRA by its exchange clients under Regulatory Services Agreements, and this additional information would allow FINRA to have comparable information for both ATSS and exchanges.

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13. Similarly, an ATS that is registered as an Alternative Display Facility (ADF) Trading Center and displays quotations on the ADF, of which there currently is only one such ATS, is subject to separate order reporting requirements under Rule 6250, which require that the ADF Trading Center report order information that will link an order to a quote that is displayed on the ADF. For such ATSs, the proposed rule would incorporate certain reporting requirements of Rule 6250, but would not require duplicative reporting for an ADF Trading Center.
14. A “lit” ATS displays subscriber orders and, if that ATS meets the applicable volume thresholds, makes its best bid and best offer available for publication in the consolidated quotation data. A “dark” ATS does not make such quotation information available within the ATS or for publication in the consolidated quotation data. *See* 17 CFR 242.301(b)(3).
15. This is the same threshold that was proposed, although never adopted, by the SEC in its proposed rulemaking to lower the trading volume threshold in Regulation ATS that triggers the obligation for ATSS to display their best-priced orders in the consolidated quotation data. *See* Securities Exchange Release No. 60997 (November 13, 2009), 74 FR 61208 (November 23 2009).
16. For an ATS that displays quotations on the ADF, the rule will incorporate certain reporting requirements from Rule 6250, which require that the ADF Trading Center report order information that will link an order to a quote that is displayed on the ADF.
17. FINRA notes that, for the period between May 12, 2014, through June 23, 2014, ATSS accounted for 16 percent of the volume of NMS stocks by shares traded.

ATTACHMENT A

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

FINRA Rules

4554. Alternative Trading Systems - Recording and Reporting Requirements of Order and Execution Information for NMS Stocks

(a) Subject to the terms and conditions contained herein, each Qualifying ATS must record each item of information described below for each order it receives in an NMS stock, as defined in Rule 600(b)(47) of SEC Regulation NMS, from a subscriber or from another broker-dealer. For purposes of this Rule, the term "order" includes a broker-dealer's proprietary quotes that are transmitted to an ATS. All Qualifying ATSs must report this information to FINRA as specified below.

(1) Order Receipt:

All orders received by a Qualifying ATS must be recorded and reported to OATS pursuant to FINRA Rules 7440 and 7450. The following additional fields must also be recorded and reported to FINRA by the Qualifying ATS when reporting receipt of the order to OATS:

(A) unique identifier assigned to the order by the ATS, as applicable;

(B) the time the order was communicated to the ATS matching engine if different than the time of receipt reported pursuant to FINRA Rule 7440(b)(16), and the time when the order was placed on the book for execution, with such information reported in the finest increment (e.g., milliseconds) that is captured in the system of such ATS;

(C) ATS book sequence id for the event;

(D) whether the order was marketable upon arrival;

(E) whether the order was not marketable and was placed on the book;

(F) display quantity;

(G) total quantity available for execution at the ATS at the time the order was received by the ATS;

(H) price at which the order was displayed and/or price at which order was placed on the ATS book (e.g., if not displayed);

(I) specific pricing instructions such as pegging, including specific benchmarks;

(J) highest (buy orders) or lowest (sell orders) price at which the order can currently execute within the ATS;

(K) order display instructions and limits, such as the maximum number of shares for the order that can be displayed at any given time, display range, etc.; and

(L) any other information as specified by FINRA or the SEC.

(2) ATS book sequence ID, when the Qualifying ATS reports any of the following events to OATS pursuant to FINRA Rules 7440 and 7450:

(A) order executions at the ATS;

(B) order cancellations;

(C) order modifications; and

(D) order transmittal to another market center.

(3) ATS Book Price and Size Changes

(A) whether price and/or size of shares available for execution changed (e.g., price change or size change);

(B) the order receiving firm order ID, as that term is described in Rule 7440(b)(1) and the OATS Reporting Technical Specifications;

(C) unique identifier assigned to the order by the ATS, as applicable;

(D) price or size change timestamp;

(E) reason for price and/or size change;

(F) ATS book sequence id for the event;

(G) new display quantity and total quantity of the order executable at ATS resulting from the order event update;

(H) new limit and displayed price and the new highest (lowest) price of the buy (sell) order resulting from the order update event;

(I) new order display limits, such as a new display range resulting from the order update event; and

(J) any other information as specified by FINRA.

The information described in subparagraphs (1) through (3) must be reported to FINRA by no later than 8:00 a.m. Eastern Time on the calendar day following of receipt of the order in an electronic form as prescribed by FINRA.

(b) Qualifying ATs that are also registered as ADF Trading Centers, as defined in Rule 6220, must also record and report to FINRA, as specified below, the following information for each bid or offer displayed on the ADF:

(1) symbol;

(2) quote identifier provided to the ADF Facility;

(3) quote generation timestamp;

(4) the Order Receiving Firm Order ID, as that term is described in Rule 7440(b) (1) and the OATS Reporting Technical Specifications for each order that is part of the displayed bid or offer;

(5) unique identifier assigned to the order by the ATS, as applicable, for each order that is part of the displayed bid or offer; and

(6) any other information as specified by FINRA or the SEC.

The information described in paragraph (b) shall be reported to FINRA no later than 8:00 a.m. Eastern Time on the calendar day following receipt of the order in an electronic form as prescribed by FINRA; provided, however, that an ATS that is also registered as an ADF Trading Center must report any information described in this paragraph (b) to FINRA immediately upon request. Any information related to time must be reported in the finest increment (e.g., milliseconds) that is captured in the system of such ATS.

(c) "Qualifying ATS" means any ATS, as defined in Rule 300 of SEC Regulation ATS, that accounts for more than 0.25% of consolidated market share in any NMS stock over a one-month period. Once an ATS has exceeded the threshold for one NMS stock, it will be required to report order information for all NMS stocks for which the ATS receives an order. Once an ATS is deemed a Qualifying ATS, it must fall under the 0.25% market share threshold, and remain below that threshold for six months, to no longer be considered a Qualifying ATS and be relieved of its reporting obligation.

(d) Members shall transmit this information in such form as prescribed by FINRA.

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6250. Quote and Order Access Requirements

(a) through (b) No Change

(c) An ADF Trading Center that is an ATS must report the information required in Rule 4554. For each bid or offer displayed by [an ADF Trading Center] a Registered Reporting ADF Market Maker on the ADF, the [ADF Trading Center] Registered Reporting ADF Market Maker must record and report to FINRA the following information in such form as prescribed by FINRA.

(1) All [ADF Trading Centers] Registered Reporting ADF Market Makers must record and report the following information for each order that is part of a displayed bid or offer, including:

(A) through (M) No Change

(2) All [ADF Trading Centers] Registered Reporting ADF Market Makers must also record and report the execution details, if any, of each order that is part of a displayed bid or offer, including:

(A) through (L) No Change

The information described in paragraphs (1) and (2) shall be reported to FINRA in “next day” file submission, with such information reported to FINRA no later than 8:00 a.m. Eastern Time on the day following receipt of the order; provided, however, that an [ADF Trading Center] Registered Reporting ADF Market Maker must report any information described in paragraphs (1) and (2) to FINRA immediately upon request. Any information related to time must be reported in the finest increment (e.g., milliseconds) that is captured in the [ADF Trading Center’s] Registered Reporting ADF Market Maker’s system.

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7440. Recording of Order Information

(a) Procedures

No Change.

(b) Order Origination and Receipt

Unless otherwise indicated, the following order information must be recorded under this Rule when an order is received or originated. For purposes of this Rule, the order origination or receipt time is the time the order is received from the customer.

(1) through (18) No Change.

(19) where the Reporting Member receives an order from a broker-dealer that is not a member, identification of the non-member broker-dealer; and

([19]20) if the member is relying on the exception provided in Rule 5320.02 with respect to the order, the unique identification of any appropriate information barriers in place at the department within the member where the order was received or originated.

(c) Order Transmittal

No Change.

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