

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-69561; File No. SR-FINRA-2013-013)

May 13, 2013

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving the Proposed Rule Change, as Modified by Amendment No. 1, to Require Members to Report OTC Equity Transactions As Soon As Practicable, But No Later Than 10 Seconds, Following Execution

I. Introduction

On February 1, 2013, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”), 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> a proposed rule change to require that members report over-the-counter (“OTC”) transactions in NMS stocks and OTC Equity Securities,<sup>3</sup> and cancellations of such transactions, to FINRA as soon as practicable, but no later than 10 seconds, following execution (or cancellation, as applicable). The proposed rule change was published for comment in the Federal Register on February 12, 2013.<sup>4</sup> The Commission received five comment letters in response to the proposed rule change.<sup>5</sup> On May 7,

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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> OTC transactions in NMS stocks, as defined in SEC Rule 600(b) of Regulation NMS, are reported through the Alternative Display Facility (“ADF”) or a Trade Reporting Facility (“TRF”), and transactions in “OTC Equity Securities,” as defined in FINRA Rule 6420 (*i.e.*, non-NMS stocks such as OTC Bulletin Board and OTC Market securities), are reported through the OTC Reporting Facility (“ORF”). The ADF, TRFs and ORF are collectively referred to herein as the “FINRA Facilities.”

<sup>4</sup> See Securities Exchange Act Release No. 68842 (February 6, 2013), 78 FR 9963 (“Notice”).

<sup>5</sup> See Letter from Christopher Nagy, President, KOR Trading LLC to Elizabeth M. Murphy, Secretary, Commission, dated March 5, 2013 (“KOR Letter”); Letter from David J. Amster, Chief Compliance Officer, CRT Capital Group to the Commission, dated March 5, 2013 (“CRT Letter”); Letter from David S. Sieradzki, Partner, Bracewell & Giuliani LLP on behalf of GFI Securities LLC to Elizabeth M. Murphy, Secretary, Commission, dated March 5, 2013 (“GFI Letter”); Letter from Manisha Kimmel,

2013 FINRA responded to the comment letters and filed Amendment No. 1 to the proposed rule change.<sup>6</sup> This order approves the proposed rule change, as modified by Amendment No. 1.

## II. Description of the Proposal

FINRA trade reporting rules currently require that members report OTC transactions in NMS stocks and OTC Equity Securities that are executed during the hours that the FINRA Facilities are open within 30 seconds of execution.<sup>7</sup> In addition, members must report the cancellation of a trade within 30 seconds of the time of cancellation if the trade is both executed and cancelled on the same day during normal market hours.<sup>8</sup> Under current FINRA guidance, members are expected to report transactions as soon as practicable and would violate the rule if

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Executive Director, Financial Information Forum to Elizabeth M. Murphy, Secretary, Commission, dated March 6, 2013 (“FIF Letter”); and Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association to Elizabeth M. Murphy, Secretary, Commission, dated March 18, 2013 (“SIFMA Letter”).

<sup>6</sup> See Letter from Stephanie Dumont, Senior Vice President and Director of Capital Markets Policy, FINRA to the Commission dated May 7, 2013 (“FINRA Response”). See also Amendment No. 1 dated May 7, 2013 (FINRA proposed to adopt Supplementary Material to provide it will take such factors as the complexity and manual nature of the execution and reporting of the trade into consideration in determining whether “reasonable justification” exists to excuse what otherwise may be deemed to be a pattern or practice of late trade reporting). (“Amendment No. 1”). Because Amendment No. 1 is technical in nature, it is not subject to notice and comment.

<sup>7</sup> See, e.g., FINRA Rules 6282(a), 6380A(a), 6380B(a) and 6622(a).

The TRFs and ORF are open between 8:00 a.m. and 8:00 p.m., and the ADF is open between 8:00 a.m. and 6:30 p.m.

<sup>8</sup> See, e.g., FINRA Rules 6282(j)(2)(A), 6380A(g)(2)(A), 6380B(f)(2)(A) and 6622(f)(2)(A).

Members must report all cancellations of previously reported trades to FINRA; however, where the trade is executed or canceled outside of normal market hours, the 30-second requirement does not apply to the reporting of the cancellation.

they withhold trade reports, e.g., by programming their systems to delay reporting until the last permissible second.<sup>9</sup>

FINRA proposed to amend its trade reporting rules to require members to report OTC transactions in NMS stocks and OTC Equity Securities as soon as practicable, but no later than 10 seconds, following execution and to report trade cancellations as soon as practicable, but no later than 10 seconds, after the time of cancellation.<sup>10</sup> Under the proposed rule change, all transactions not reported within 10 seconds will be marked late (unless expressly subject to a different reporting requirement<sup>11</sup> or excluded from the trade reporting rules altogether). In the filing, FINRA stated that it understands that there will be isolated instances where a member is unable to report trades within the time period prescribed by rule, and FINRA will continue to look for a pattern or practice<sup>12</sup> of unexcused late trade reporting before taking action against a member. Pursuant to FINRA Rules 6181 and 6623, unexcused late reporting occurs when there are “repeated reports of executions submitted after the required time period without reasonable justification or exceptional circumstances.” The rules also provide that “[e]xceptional circumstances will be determined on a case-by-case basis and may include instances of system failure by a member or service bureau, or unusual market conditions, such as extreme volatility in a security, or in the market as a whole.”

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<sup>9</sup> See FINRA Regulatory Notice 10-24 (April 2010).

<sup>10</sup> FINRA also is proposing conforming changes to replace the reference to 30 seconds with 10 seconds in the rules relating to the reporting of stop stock and “prior reference price” transactions. See FINRA Rules 6282(a)(4), 6380A(a)(5), 6380B(a)(5) and 6622(a)(5).

<sup>11</sup> For example, the proposed rule change will not amend the reporting requirements applicable to transactions in Restricted Equity Securities, as defined in Rule 6420, effected under Securities Act Rule 144A, which transactions currently are not subject to the 30-second reporting requirement. See Rule 6622(a)(3).

<sup>12</sup> See, e.g., FINRA Rule 6282. See also Amendment No. 1.

FINRA also proposed to adopt Supplementary Material to clarify the requirement that members report trades and trade cancellations “as soon as practicable.” Specifically, the proposed Supplementary Material provides that members must adopt policies and procedures reasonably designed to achieve compliance with this requirement and must program systems to commence the trade reporting process without delay upon execution (or cancellation, as applicable). Where a member has such reasonably designed policies, procedures and systems in place, the member will not be viewed as violating the “as soon as practicable” requirement because of delays in trade reporting that are due to external factors so long as the member does not purposely delay the reporting of the trade. The proposed Supplementary Material also expressly prohibits members from purposely withholding trade reports, e.g., by programming their systems to delay reporting until the last permissible second. FINRA notes that members that engage in a pattern and practice<sup>13</sup> of unexcused late reporting (i.e., reporting later than 10 seconds after execution) may be charged with violating FINRA rules, notwithstanding that they have policies and procedures that contemplate commencing the trade reporting process without delay.<sup>14</sup>

### III. Summary of Comment Letters and FINRA’s Response

The Commission received five comment letters on the proposed rule change.<sup>15</sup> One commenter supported the proposed rule change.<sup>16</sup> KOR stated that in today’s automated market structure, 10 seconds represents a significant amount of time given “that the exchanges and

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<sup>13</sup> Id.

<sup>14</sup> FINRA will announce the effective date of the proposed rule change in a Regulatory Notice with an implementation period of 120 to 180 days following Commission approval.

<sup>15</sup> See note 5, supra.

<sup>16</sup> See KOR Letter.

trading firms commonly measure performance in microseconds.” KOR stated that complying with this requirement should not represent an undue burden on reporting firms. The other four commenters raised concerns relating to the proposed rule change

A. Manually Negotiated and Reported Trades

Four commenters raised concerns about the possible impact of the proposed rule change on trades that are manually negotiated and reported.<sup>17</sup> These commenters stated that while manual trading represents a very small percentage of equity trade reporting, for these types of trades, a trader may not be able to manually input and verify trade data within 10 seconds.<sup>18</sup> One commenter asserted that the proposed rule change will disproportionately affect firms that accept orders that are not electronically entered into an order management system (including orders received via telephone or instant message) and will effectively prohibit, by trade reporting rule, an entire category of otherwise appropriate transactions.<sup>19</sup>

FINRA responded that it believes that the proposed rule change is necessary to bring the trade reporting rules in line with current industry practice, as the market becomes more automated and more efficient.<sup>20</sup> Under the proposed rule change, members must have policies and procedures reasonably designed to enable them to comply with the “as soon as practicable” requirement and must program systems to commence the trade reporting process without delay upon execution. Where a member has such reasonably designed policies, procedures and systems in place, the member will not be viewed as violating the “as soon as practicable” requirement because of delays in trade reporting that are due to extrinsic factors that are not

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<sup>17</sup> See GFI Letter, CRT Letter, FIF Letter and SIFMA Letter.

<sup>18</sup> Id.

<sup>19</sup> See GFI Letter.

<sup>20</sup> See FINRA Response.

reasonably predictable and where the member does not purposely delay the reporting of the trade.<sup>21</sup> FINRA further stated that members that engage in a pattern or practice of unexcused late reporting (i.e., reporting later than 10 seconds after execution) may be charged with violating FINRA rules, notwithstanding that they have policies and procedures that contemplate commencing the trade reporting process without delay.

FINRA also noted that the universe of trades for which trade details must be entered manually is small, but in Amendment No. 1 proposed to adopt Supplementary Material to provide that in these cases, FINRA will take such factors as the complexity and manual nature of the execution and reporting of the trade into consideration in determining whether “reasonable justification” exists for what otherwise might be deemed to be a pattern or practice of late trade reporting.<sup>22</sup> FINRA noted that the proposed Supplementary Material would apply only where the details of a trade must be manually entered or typed into a trade reporting system following execution.

#### B. Benefits of Proposed Rule Change

Three commenters questioned whether the benefits outweigh the costs of the proposed rule change, given that the vast majority of trades are reported within 10 seconds already.<sup>23</sup> One

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<sup>21</sup> In Amendment No. 1, FINRA proposed to amend and further clarify the text of the Supplementary Material proposed in the original filing. FINRA proposed to delete the word “generally” and to change “external factors” to “extrinsic factors that are not reasonably predictable.”

<sup>22</sup> Pursuant to Rules 6181 and 6623, unexcused late reporting occurs when there are “repeated reports of executions submitted after the required time period without reasonable justification or exceptional circumstances.” In Amendment No. 1, FINRA also proposed to amend Rules 6282(a)(6), 6380A(a)(4), 6380B(a)(4) and 6622(a)(4) to include the words “reasonable justification” to conform to Rules 6181 and 6623.

<sup>23</sup> See GFI Letter, FIF Letter and SIFMA Letter.

of the commenters further stated that the proposed rule change should not be approved without a specific regulatory justification and a thoughtful economic analysis.<sup>24</sup>

FINRA responded that it believes that the reasons discussed in the original filing support approval of the proposed rule change,<sup>25</sup> including the potential effect of the current 30-second reporting requirement on the calculation of reference prices under the Limit Up/Limit Down Plan,<sup>26</sup> and the fact that trade reports received 30 seconds after execution are more likely to appear to market participants as violations of the Limit Up/Limit Down Plan and the Order Protection Rule (i.e., trading at a price worse than the best displayed bid or offer, commonly referred to as a “trade-through”).<sup>27</sup> Additionally, FINRA stated that the proposed rule change will give market participants greater certainty that any trade disseminated as timely reported was executed within the prior 10 seconds, in furtherance of the policy objectives underlying the proposed rule change. FINRA noted that under the 30 second reporting requirement, market participants cannot distinguish among trades reported 10, 20, or 29 seconds after execution, so it is not possible to know if a particular trade reflects the current market for the security. FINRA believes that with the accommodation for manual reporting processes discussed above, the proposed rule change strikes a reasonable balance between promoting the goals of increased automation and efficiency in the marketplace and minimizing the potential burden on member firms of having to make changes to comply with the 10 second reporting requirement.

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<sup>24</sup> See SIFMA Letter. The Commission notes that in the proposal FINRA stated that it 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.

<sup>25</sup> See FINRA Response.

<sup>26</sup> See Securities Exchange Act Release No. 67091, 77 FR 33498 (June 6, 2012) (File No. 4-631) (as originally approved, the National Market System Plan to Address Extraordinary Market Volatility, i.e., the Limit Up/Limit Down Plan).

<sup>27</sup> 17 CFR 242.611.

C. Member Firm Compliance with 10-second Reporting Requirement During High Volume Periods

Two commenters raised potential queuing issues and question whether firms will be able to comply with the proposed 10-second reporting requirement during regularly occurring periods of high volume such as market open and close, during highly subscribed initial public offerings (“IPOs”) or when a firm is reporting basket trades with a large number of securities.<sup>28</sup>

FINRA responded that under current FINRA Rules 6181 and 6623, unusual market conditions, such as extreme volatility in a security or in the market as a whole, may be considered in determining whether reasonable justification or exceptional circumstances exists for the late trade reporting.<sup>29</sup> FINRA reiterated that firms are expected to have sufficiently robust systems with adequate capacity to enable them to report within the time frame prescribed by FINRA rules, including during particularly high volume periods such as market open and close. Absent extraordinary circumstances or reasonable justification, a pattern or practice of late trade reporting, for example, at market open generally would not be considered “excused” under FINRA rules. FINRA stated that to create a separate standard for trade reporting at market open and close, as one commenter suggested,<sup>30</sup> or to otherwise excuse late trade reporting during such periods, would permit trade reports to be less clearly sequenced at times when transaction information is most important to investors and market participants. FINRA stated that this could obscure undesirable trading patterns such as gaming or other forms of market abuse. In addition,

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<sup>28</sup> See FIF Letter and SIFMA Letter.

<sup>29</sup> The rules state that “[e]xceptional circumstances will be determined on a case-by-case basis and may include instances of system failure by a member or service bureau, or unusual market conditions, such as extreme volatility in a security, or in the market as a whole.” In its response, FINRA noted that one example of unusual market conditions could be the day of the Russell rebalancing. See FINRA Response.

<sup>30</sup> See FIF Letter.



according to FINRA, such an approach would fail to provide firms with the appropriate incentive to devote sufficient resources to trade reporting as promptly as possible during such periods. FINRA concluded that firms must take reasonable steps to ensure that they can report trades within 10 seconds.<sup>31</sup>

D. Member Firm Compliance with 10-second Reporting Requirement Following Migration to FINRA’s Multi-Product Platform (“MPP”)

One commenter questioned whether firms will be able to comply with the proposed 10-second reporting requirement when reporting trades to the ORF<sup>32</sup> following migration to FINRA’s new MPP and asserted that introducing new trade reporting requirements before the migration is premature.<sup>33</sup>

FINRA responded that it did not believe that the planned migration of the ORF to the new MPP infrastructure would affect the ability of a firm’s automated trade reporting systems to comply with the proposed rule change. According to FINRA, if a firm’s systems currently are capable of reporting within 10 seconds, there is nothing about the new platform that would impede this process. In addition, FINRA believes that the proposed implementation period of 120 to 180 days following Commission approval will provide sufficient time for firms to make and test any systems changes that may be required to comply with the proposed rule change. In addition, FINRA recently announced a new timeframe for the migration of the ORF to the MPP

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<sup>31</sup> In response to the comment regarding IPOs, FINRA noted that, to date, FINRA has not observed a negative effect on trade reporting compliance rates during time periods surrounding highly subscribed IPOs and believes that this will continue to be the case under the proposed rule change.

<sup>32</sup> The Commission notes that the commenter’s more general comments regarding ORF migration to the MPP are not germane to this filing and are not addressed here.

<sup>33</sup> See FIF Letter.

which will occur in early 2014.<sup>34</sup> FINRA stated that this schedule change should further alleviate members' concerns regarding the timing of implementation of the proposed rule change. Accordingly, FINRA does not believe that implementation of the proposed rule change should be delayed pending migration of the ORF to the MPP.

#### IV. Discussion and Commission Findings

After carefully considering the proposal, the comments submitted, and FINRA's response to the comments, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.<sup>35</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,<sup>36</sup> which requires, among other things, that FINRA rules 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. The Commission has considered the commenters' views on the proposed rule change and believes that FINRA responded appropriately to the concerns raised. Indeed, the Commission believes that the proposal promotes the goals of transparency, consistency in trade reporting and dissemination, and timely reporting by FINRA members.

Furthermore, the Commission believes that the proposal is consistent with Section 11A(a)(1)(C)(iii) of the Act,<sup>37</sup> which sets forth Congress' finding that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to

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<sup>34</sup> See <http://www.finra.org/Industry/Compliance/MarketTransparency/ORF/Notices/P239727>.

<sup>35</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>36</sup> 15 U.S.C. 78o-3(b)(6).

<sup>37</sup> 15 U.S.C. 78k-1(a)(1)(C)(iii).

assure the availability to brokers, dealers, and investors of information with respect to quotations and transactions in securities. The Commission believes that these goals are furthered by the proposed changes requiring that members report OTC transactions in NMS stocks and OTC Equity Securities, and cancellations of such transactions, to FINRA as soon as practicable, but no later than 10 seconds, following execution (or cancellation, as applicable). The proposed rule change is reasonably designed to accomplish these goals by shortening the time within which FINRA members must report trades. As FINRA stated in its proposal, timely reporting has become even more critical with the implementation of the Single Stock Circuit Breaker trading pause rules and the Limit Up/Limit Down Plan. These initiatives are triggered by specified movements in stock prices, thus it is even more important that trades be reported in the sequence in which they occur so that a single stock circuit breaker is not triggered off of a trade report that is out of sequence. The regulatory landscape is become increasingly more automated and the vast majority of trades are now reported in a much shorter period of time than currently required.<sup>38</sup> As noted by one commenter, firms and exchanges measure performance in microseconds.<sup>39</sup>

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<sup>38</sup> For example, FINRA noted that during the period of July 9 through July 13, 2012, 99.96% of last-sale eligible trades were reported within 10 seconds of execution (with a breakdown of 99.97% of OTC trades in NMS stocks and 99.04% of OTC trades in OTC Equity Securities). During the same period, 288 member firms reported one or more OTC trades to FINRA. Of these firms, only 12 were unable to report any of their trades within 10 seconds. Of the 25,251,098 last sale eligible trades reported during this period, the total number of trades reported by these 12 firms was 21 (0.0000831% of the total number of trades). In addition, there were only 22 member firms that were unable to report at least 50% of their last sale eligible trades within 10 seconds (this number includes the 12 firms mentioned above). The total number of trades reported by these 22 firms was 899 (0.0035602% of the total number of trades). The majority of the firms that FINRA spoke to indicated that their business model is not to execute and report trades, but instead to route most of their orders to other firms for execution, while a few other firms indicated that, as a more general matter, they do not trade equities very frequently. FINRA also stated that it believes that the burden of the proposed rule change should be

However, four commenters asserted that the proposal places an undue burden on firms with processes that are manual in nature.<sup>40</sup> In response to this comment, in Amendment No. 1, FINRA stated that it will take such factors as the complexity and manual nature of the execution and reporting of the trade into consideration in determining whether “reasonable justification” exists for what otherwise might be deemed to be a pattern or practice of late trade reporting.<sup>41</sup> The Commission supports FINRA’s expectation that members must periodically assess their reporting processes, manual or otherwise, to ensure that they implement the most efficient policies and procedures for trade reporting possible.<sup>42</sup>

Commenters also raised concerns on whether the benefits of the proposed rule change outweigh the costs associated with compliance.<sup>43</sup> In its filing with the Commission, FINRA stated its belief that the proposed rule change will enhance market transparency and price discovery, promote more consistent trade reporting by members and facilitate implementation and further the goals of the Single Stock Circuit Breaker trading pause rules and the Limit Up/Limit Down Plan. Although the Commission acknowledges the potential for firms covered by these new reporting requirements to incur additional compliance burdens and costs, the

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minimal, particularly since, FINRA looks to a pattern and practice of late trade reporting and typically does not charge a member for isolated instances of late reporting. See Notice, supra note 4.

<sup>39</sup> See KOR Letter.

<sup>40</sup> See note 17, supra, and accompanying text.

<sup>41</sup> The Commission notes that FINRA is not proposing a separate standard for designating manual trades as timely versus late for purposes of dissemination. All trades that are reported more than 10 seconds after execution, regardless of whether they are reported automatically or manually, would be identified as late for reporting and dissemination purposes and would not be considered “last sale” eligible under the CTA and UTP Plans. See FINRA Response and Amendment No. 1.

<sup>42</sup> See FINRA Response.

<sup>43</sup> See note 23 supra, and accompanying text.

Commission believes that any such burdens are outweighed by the overall benefits of increased transparency and access to more comprehensive and accurately sequenced trade information in the OTC markets.

Two commenters raised potential queuing issues and question whether firms will be able to comply with the proposed 10-second reporting requirement during regularly occurring periods of high volume such as market open and close, during highly subscribed IPOs or when a firm is reporting basket trades with a large number of securities.<sup>44</sup> The Commission agrees with FINRA's response that under current rules, unusual market conditions, such as extreme volatility in a security or in the market as a whole, may be considered in determining whether reasonable justification or exceptional circumstances exists to explain late trade reporting.<sup>45</sup>

One commenter questioned whether firms will be able to comply with the proposed 10-second reporting requirement when reporting trades to the ORF following migration to FINRA's new MPP and asserted that introducing new trade reporting requirements before the migration is premature.<sup>46</sup> FINRA responded that it did not believe that the planned migration of the ORF to the new MPP infrastructure would affect the ability of a firm's automated trade reporting systems to ensure compliance with the proposed rule change and further elaborated on this justification.<sup>47</sup> The Commission believes that FINRA adequately responded to this concern and additionally notes that the proposed implementation period of 120 to 180 days following Commission approval will provide sufficient time for firms to make and test any systems changes that may be required to comply with the proposed rule change.

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<sup>44</sup> See note 28, supra and accompanying text.

<sup>45</sup> See FINRA Response.

<sup>46</sup> See note 33, supra and accompanying text.

<sup>47</sup> The Commission notes that FINRA has revised its migration schedule; this change will be implemented before the migration to the new platform.

Moreover, the Commission shares FINRA's belief that the proposed rule change will enhance market transparency and price discovery, promote more consistent and accurately sequenced trade reporting by members and facilitate implementation and further the goals of the Single Stock Circuit Breaker trading pause rules and the Limit Up/Limit Down Plan. As FINRA stated in submitting its proposal, timely reporting has become even more critical with the implementation of Regulation NMS and these other regulatory initiatives. Additionally, the proposed rule change will lessen the ability of members to withhold important market information from investors and other market participants for competitive or other improper reasons. Going forward, the Commission expects FINRA to monitor the effect of this change and to consider the need to lower the time within which trades must be reported even further.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-FINRA-2013-013), as modified by Amendment No. 1, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>48</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>48</sup> 17 CFR 200.30-3(a)(12).