

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56199; File No. SR-FINRA-2007-001)

August 3, 2007

Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to the Reporting of Foreign Equity Securities to the Order Audit Trail System

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 July 31, 2007, the Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a the National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by FINRA. 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 to amend Rule 6952 to exclude certain orders and transactions in foreign equity securities from the Order Audit Trail System (“OATS”) recording and reporting requirements. The text of the proposed rule change is available at FINRA, the Commission’s Public Reference Room, and www.finra.org.

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

NASD Rules 6950 through 6958 (“OATS Rules”) impose obligations on member firms to record in electronic form and report to OATS on a daily basis certain information regarding orders in Nasdaq-listed equity securities originated, received, transmitted, modified, canceled, or executed by members.³ FINRA integrates the OATS information with quote and transaction information to create a time-sequenced record of orders, quotes, and transactions.

Currently, a member has recording and reporting obligations under the OATS Rules only with respect to orders in Nasdaq-listed equity securities. On October 10, 2006, the Commission approved SR-NASD-2005-101, which amended the OATS Rules and extended the OATS obligations to include orders in OTC equity securities.⁴ As amended by SR-NASD-2005-101, Rule 6951 defines the term “OTC equity security” to mean “any equity security that: (1) is not listed on a national securities exchange; or (2) is listed on one or more regional stock exchanges and does not qualify for dissemination of transaction reports via the facilities of the Consolidated

³ Beginning on February 4, 2008, members also will be required to record and report order information regarding all OTC equity securities, as defined in NASD Rule 6951. See Securities Exchange Act Release No. 54585 (October 10, 2006); 71 FR 61112 (October 17, 2006) (SR-NASD-2005-101); NASD Notice to Members 06-70 (December 2006); see also Securities Exchange Act Release No. 55440 (March 9, 2007), 72 FR 12852 (March 19, 2007) (SR-NASD-2007-019).

⁴ See Securities Exchange Act Release No. 54585 (October 10, 2006); 71 FR 61112 (October 17, 2006) (SR-NASD-2005-101); NASD Notice to Members 06-70 (December 2006). The effective date of these amendments to the OATS Rules is February 4, 2008. See Securities Exchange Act Release No. 55440 (March 9, 2007), 72 FR 12852 (March 19, 2007) (SR-NASD-2007-019).

Tape.” This broad definition of “OTC equity security” encompasses essentially all foreign equity securities, except those that are listed on a U.S. national securities exchange.

After the Commission’s approval of SR-NASD-2005-101 and the publication of NASD Notice to Members 06-70 in December 2006, numerous member firms and industry organizations raised issues with FINRA staff regarding the breadth of the application of the OATS Rules to foreign equity securities. The issues that were raised included the lack of U.S. symbols for many foreign securities, the programming difficulties associated with tracking trades in foreign symbols and currencies, and the fact that, for many firms, orders for foreign securities are handled by foreign affiliates that are not currently set up to record and report OATS information. In addition, many trades in foreign equity securities are routed to foreign broker-dealers and executed on a foreign stock exchange. Consequently, although FINRA would receive OATS information regarding the order origination and routing for such orders, FINRA would not receive execution reports, and FINRA would not have trade reporting data to consolidate with the OATS data.⁵

In response to these concerns, FINRA reconsidered the issues associated with extending the OATS recording and reporting obligations to all foreign equity securities in light of the regulatory benefit provided by the information. FINRA has filed the proposed rule change to strike an appropriate balance between ensuring that FINRA can effectively monitor members’ compliance with their order handling obligations (e.g., best execution and limit order protection) and avoiding overly burdensome reporting requirements. FINRA has concluded that the

⁵ Trade reporting requirements under NASD Rule 6620 do not extend to a member’s transactions in foreign equity securities executed on and reported to a foreign securities exchange or transactions executed over-the-counter in a foreign country that are reported to the regulator of securities markets for that country. See NASD Rule 6620(g); Securities Exchange Act Release No. 55745 (May 11, 2007), 72 FR 27891 (May 17, 2007) (SR-NASD-2007-030).

appropriate balance would be achieved by requiring firms to record and report order information regarding foreign equity securities only in those instances where any resulting execution is subject to the transaction reporting requirements in Rule 6620. This will provide FINRA with order information for the same transactions for which FINRA receives trade reporting information, thus allowing FINRA to review a complete audit trail of those transactions. At the same time, firms will not be required to record and submit information to FINRA for orders in a foreign equity security that do not result in a trade report to FINRA.

At least two situations can arise in connection with orders for foreign equity securities that trade in the U.S. and abroad that may raise questions as to how these orders should be reported to OATS. In some circumstances, an order for a foreign equity security that is traded in the U.S. and abroad may be broken up and executed in multiple markets. If a firm breaks up an order and, as a result, part of the order is executed in the U.S. and part of the order is executed in a foreign market, the firm should report the entire order to OATS. The part of the order that was executed abroad should be reported as a route to a foreign broker-dealer or a foreign market (i.e., the firm is a member of the foreign market and is able to route the order directly to the foreign market), and the part of the order that was executed in the U.S. would be reported the same way as any other reportable order event.

Similarly, with respect to foreign equity securities that trade in the U.S. and abroad, a firm may receive an order for such a security in the U.S. symbol and, at the time the order is received, the firm is uncertain whether the order will be executed in the U.S. or in the foreign market. In some cases, the trade may not be executed the day it is received. If the order is not executed before the firm is required to submit its OATS information for that day, the firm would not know whether it was required to report the receipt of the order to OATS because the firm

would not yet have a trade reporting obligation. In such a case, because the security had a U.S. symbol and the customer placed the order in the U.S. symbol, the firm should report the new order to OATS as though it were going to be executed in the U.S. (and, thus be subject to the trade reporting requirements).⁶ If the order is later executed in a foreign market, the firm would submit a route report indicating that the order was routed to a foreign broker-dealer or foreign market, as applicable. Of course, if a firm receives an order and executes that order the same day in a foreign market, no OATS report would be necessary if the firm was not required to report the transaction under Rule 6620.

Reportable Order Events for Foreign Equity Securities with No U.S. Symbol

When a firm has a trade reporting obligation in a foreign equity security that does not have a U.S. symbol assigned to it at the time of the trade, the firm is required to: (1) promptly request a symbol so that it can comply with its trade reporting obligations; and (2) comply with the OATS recording requirements under Rule 6954. Once a symbol is assigned, the member must report the trade to FINRA and report all applicable order information to OATS in accordance with Rule 6955. When reporting the information to OATS, the firm must properly code the report to indicate that the reported event occurred prior to the date of the OATS report. In these situations, if normal electronic trade reporting submission is not possible (e.g., the trade reporting facility will not accept a report because the foreign equity security had not been assigned a valid U.S. symbol on the actual trade date), the firm is required to report the

⁶ If the security had no U.S. symbol, the firm could not report the information to OATS until a U.S. symbol is assigned. If the security has both a U.S. and foreign symbol and the order is received from the customer in the foreign symbol, the member would not be required to report the order to OATS unless the order is executed and trade reported to FINRA pursuant to Rule 6620 on the same day the order was received from the customer.

transaction as soon as practicable on Form T.⁷

In these instances where a Form T is used for trade reporting purposes, FINRA intends to provide firms the option of reporting the required OATS information through the firm's normal OATS reporting channels or as part of the Form T submission. In this way, firms will be able to fulfill both the firm's trade reporting and OATS obligations through its Form T submission.⁸

The ability to use a Form T to report OATS information will be available only for trades in foreign equity securities that do not have a U.S. symbol assigned at the time the OATS information would ordinarily be reported.

The operative date of the proposed rule change will be February 4, 2008, to coincide with the implementation date for the amendments to the OATS Rules requiring members to record and report order information for OTC Equity Securities.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁹ 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 achieves a proper balance between reporting requirements that improve FINRA's ability to monitor members' order handling obligations and that have reasonable parameters regarding those orders that are subject to the requirements.

⁷ See e.g., NASD Rule 6620(a)(4) (regarding the use of Form T for trades reported to the OTC Reporting Facility).

⁸ The revised OATS Reporting Technical Specifications that will be published following Commission approval of the proposed rule change will detail the precise procedures a firm may use to file the OATS report(s) in this situation.

⁹ 15 U.S.C. 78o-3(b)(6).

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.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be 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-2007-001 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2007-001. 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 Web site (<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 inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office 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-2007-001 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Florence E. Harmon
Deputy Secretary

¹⁰ 17 CFR 200.30-3(a)(12).