SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68842; File No. SR-FINRA-2013-013)

February 6, 2013

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Require Members to Report OTC Equity Transactions As Soon As Practicable, But No Later Than 10 Seconds, Following Execution

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 February 1, 2013, 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. 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 FINRA trade reporting rules to require that members report over-the-counter ("OTC") transactions in NMS stocks and OTC Equity Securities,[3] and cancellations of such transactions, to FINRA as soon as practicable, but no later than 10 seconds, following execution (or cancellation, as applicable).

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 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."

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

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

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

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

1. Purpose

FINRA trade reporting rules 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.[4] 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.[5] Under current FINRA guidance, members are expected to report transactions as soon as practicable and should not withhold trade reports, e.g.,

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4 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.

5 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.

by programming their systems to delay reporting until the last permissible second.[6]

FINRA is proposing to amend its trade reporting rules to require members to report OTC trades 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.[7] Under the proposed rule change, all transactions not reported within 10 seconds will be marked late (unless expressly subject to a different reporting requirement[8] or excluded from the trade reporting rules altogether). FINRA 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 and practice[9] of unexcused late trade reporting before taking action against a member. 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." 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."

FINRA also is proposing to adopt Supplementary Material to clarify the requirement that

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6 See Regulatory Notice 10-24 (April 2010).

7 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).

8 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).

9 The Commission notes that FINRA Rules refer to "a pattern or practice." See, e.g., FINRA Rule 6282 (emphasis added).

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 comply with this requirement and must implement systems that 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 generally will not be viewed as violating the "as soon as practicable" requirement because of delays in trade reporting that are due to external factors where the member does not purposely intend to 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[10] 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.

Timely reporting has become even more critical with the implementation of the Single Stock Circuit Breaker trading pause rules and the upcoming implementation of the NMS Plan to Address Extraordinary Market Volatility (or "Limit Up/Limit Down") this year. For example, the price bands under Limit Up/Limit Down will be a certain percentage away from a "reference price," which is generally the average price of regular way, last-sale eligible trades for a security over the immediately preceding five-minute period. All regular way, last sale eligible trades reported within the time frame prescribed by rule (i.e., that are not reported late) will be included

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[10] Id.

in the calculation of the reference price.[11] Given how quickly the price for a security can change, a trade executed and reported in 30 seconds potentially may no longer reflect the current market and could improperly impact the calculation of reference prices or, at an extreme, trigger a single stock circuit breaker (which will remain in effect for certain NMS stocks during the phased implementation of Limit Up/Limit Down). In addition, trade reports received 30 seconds after execution are more likely to appear to market participants as violations of Limit Up/Limit Down (i.e., executions outside of the price bands), as well as the Regulation NMS Order Protection Rule (i.e., trading at a price worse than the best displayed bid or offer, commonly referred to as a "trade-through").[12] Even though the vast majority of OTC trades are reported within 10 seconds today,[13] market participants have no certainty whether a particular trade reflects the immediate current market. This is because today, when FINRA disseminates OTC trades to the consolidated "tapes,"[14] it does not distinguish between a trade reported one second after execution and a trade reported 30 seconds after execution, as both are considered timely under

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[11] By its terms, Limit Up/Limit Down will be implemented on a one-year pilot basis in two phases. Phase I is currently scheduled to begin on April 8, 2013 in select NMS stocks. Although the proposed rule change, if approved, will not be in place at the commencement of Phase I, FINRA believes it ultimately will be beneficial to the operation of Limit Up/Limit Down.

[12] For example, if a trade is not disseminated until 30 seconds after execution, the best displayed market could have changed dramatically between the time of execution and ultimate dissemination of the trade, giving the appearance of a trade-through of the then-current market.

[13] For example, 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).

[14] Trades reported for public dissemination purposes are transmitted to three "tapes" based on the listing venue of the security: New York Stock Exchange securities (Tape A), NYSE Arca, NYSE MKT and other regional exchange securities (Tape B), and Nasdaq Stock Market securities (Tape C). Tape A and Tape B are governed by the Consolidated Tape Association Plan (CTA Plan) and Tape C is governed by the Nasdaq Unlisted Trading Privileges Plan (UTP Plan).

FINRA rules.

FINRA believes that reducing the reporting time and codifying current guidance requiring that members report trades as soon as practicable and not hold back trade reports is necessary to promote consistent and timely reporting by all members. In addition, FINRA believes that the proposed rule change will help ensure that members are attentive to transaction reporting standards.

FINRA believes that very few members would be unable to comply with the proposed rule change today. For the one-week period cited in footnote 11 herein, 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). FINRA contacted more than half of the 22 firms to discuss their trade reporting protocols and the potential impact that the proposed rule change might have on them. 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,[15] while a few other firms indicated that, as a more general matter, they do not trade

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15 FINRA notes that members, particularly smaller members, that route their orders to another member for handling or execution do not have the trade reporting obligation under FINRA rules. For transactions between members, the "executing party" (which is defined 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) has the obligation to report the trade to FINRA. See Rules 6282(b), 6380A(b), 6380B(b) and 6622(b); see also Regulatory Notice 09-08 (January 2009).

equities very frequently. Accordingly, FINRA believes that the burden of the proposed rule change should be minimal, particularly since, as noted above, FINRA looks to a pattern and practice[16] of late trade reporting and typically does not charge a member for isolated instances of late reporting.

FINRA originally considered a requirement that members report transactions "immediately," but no later than 10 seconds, following execution. FINRA staff discussed the proposed rule change with several of its industry advisory committees in developing its approach. While these committees were generally supportive of the proposal, they indicated the need for (1) a sufficient implementation period so that members can make any necessary systems changes (as noted above, FINRA is proposing a 120 to 180 day implementation period following Commission approval); (2) revision of the standard from "immediately" to "as soon as practicable" and a request to provide additional clarity on the interpretation and application of the "as soon as practicable" requirement (FINRA further clarified this as part of the proposed Supplementary Material); and (3) additional guidance for situations where delays could result from queuing of data into the FINRA Facilities (given that the vast majority of trades today are reported within 10 seconds, FINRA does not believe that the proposed rule change will cause any queuing issues into the FINRA Facilities). Finally, the committees asked for guidance on how the rule would apply to late reporting during periods of market stress, e.g., high volatility days such as the Russell index rebalancing, where compliance rates could be impacted. As noted above, extraordinary market volatility is taken into consideration currently, and would continue to be considered under the proposed reporting time frame, in determining whether exceptional circumstances exist to excuse late trade reporting. FINRA also notes that its staff reviewed

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16 See, supra note 9.

members' compliance rates on the date of Russell index rebalancing in 2012 and determined that there was no appreciable decrease in the percentage of trades reported within 10 seconds of execution on that day.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice. As discussed above, a small number of members currently are unable to report trades within 10 seconds and may need to make systems changes to comply with the proposed rule change. While the vast majority of members have automated their trade reporting systems and are already reporting within the proposed time frame, even these members may need to make programming adjustments (e.g., to modify the trigger for appending the late modifier, as required under FINRA rules, from 30 seconds to 10 seconds after execution of the trade). To allow sufficient time to make the necessary systems changes, FINRA is proposing that the implementation date will be between 120 and 180 days following the date of Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[17] 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. For the reasons discussed above, FINRA believes 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 NMS Plan to Address Extraordinary Market Volatility.

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[17] 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. FINRA believes the vast majority of firms that engage in equities transactions have automated their trade reporting systems so that the proposed rule change will not have an economic impact.[18] Furthermore, FINRA believes that the proposed rule change will not have a competitive impact on smaller members that may rarely have a trade reporting obligation, given the policies and procedures approach to determining compliance with the "as soon as practicable" requirement, and the pattern and practice[19] nature of FINRA's late trade reporting surveillance and enforcement. While smaller members will be expected to adopt policies and procedures that contemplate reporting any trades for which they have the reporting obligation as soon as practicable, their infrequent instances of trade reporting likely would never rise to the level of a pattern and practice[20] of late reporting.

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 45 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

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18 This is supported by a review of member trade reporting statistics. As previously noted, during the period of July 9 through July 13, 2012, 99.96% of last-sale eligible trades were reported within 10 seconds of execution. For that same period, 99.71% and 94.31% of trades were reported within 5 seconds and 2 seconds of execution, respectively.

19 See, supra note 9.

20 Id.

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 or disapprove 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 No. SR-FINRA-2013-013 on the subject line.

Paper comments:

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

All submissions should refer to File No. SR-FINRA-2013-013. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal 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 No. SR-FINRA-2013-013 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.[21]

Kevin M. O'Neill
Deputy Secretary

[21] 17 CFR 200.30-3(a)(12).