SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-77798 ; File No. SR-FINRA-2016-010)

May 10, 2016

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change to Adopt FINRA Rule 4554, Alternative Trading Systems - Recording and Reporting Requirements of Order and Execution Information for NMS Stocks

I.      Introduction

On February 29, 2016, the 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")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to require alternative trading systems ("ATSs") to submit additional order information to FINRA.  The proposed rule change was published for comment in the Federal Register on March 7, 2016.[3]  The Commission received one comment letter on the proposal.[4]  On April 22, 2016, FINRA responded to the comment letter.[5]  This order approves the proposed rule change.

II.      Description of the Proposal

FINRA proposed Rule 4554 to impose additional reporting requirements on trading venues that have filed a Form ATS with the Commission.[6]  The proposal is intended to enhance

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

[2]      17 CFR 240.19b-4.

[3]      See Securities Exchange Act Release No. 77269 (March 1, 2016), 81 FR 11851 (March 7, 2016) ("Notice").  On April 15, 2016, the Commission extended the time period for Commission action on the proposed rule change until June 3, 2016.  See Securities Exchange Act Release No. 77635 (April 15, 2016), 81 FR 23536 (April 21, 2016).

[4]      See Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association ("SIFMA"), dated April 1, 2016 ("SIFMA Letter").

[5]      See Letter from Andrew Madar, Associate General Counsel, FINRA, dated April 22, 2016 ("FINRA Response Letter").

[6]      See 17 CFR 242.300(a).

FINRA's order-based surveillance by requiring ATSs to report additional ATS-specific order information for NMS stocks.[7] While ATSs submit order information to FINRA under the Order Audit Trail System ("OATS") rules,[8] there is order information not currently required to be reported to OATS, such as order re-pricing events and order display and reserve size information, which FINRA needs so that it can more fully reconstruct an ATS's order book and perform certain order-based surveillance.

Specifically, proposed Rule 4554 sets forth four categories of reporting requirements: (1) data to be reported by all ATSs at the time of order receipt; (2) data to be reported by all ATSs at the time of order execution; (3) data to be reported by ATSs that display subscriber orders; and (4) data to be reported by ATSs that are registered as ADF Trading Centers. The proposed requirements would apply to order and execution information for NMS stocks. ATSs would be required to report this information to FINRA consistent with current OATS reporting requirements.

Reporting requirements for receipt of orders

Proposed Rule 4554 would require, among other things, each ATS to indicate on all orders received whether it displays subscriber orders outside of the ATS (other than to ATS employees).[9] This information will enable FINRA to distinguish between ATSs that display

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[7]    See 17 CFR 242.600(b)(47).

[8]    For example, upon receipt of an order, a member must report the number of shares to which the order applies, any limit or stop price prescribed in the order, special handling requests, and the time at which the order is received. See FINRA Rule 7440(b). Upon the modification or execution of an order, the member must report the time of modification or execution, whether the order was fully or partially executed, the number of unexecuted shares remaining if the order was only partially executed, and the execution price. See FINRA Rule 7440(d).

[9]    The proposed requirements apply to any alternative trading system, as defined in Rule 300(a)(1) of SEC Regulation ATS, that has filed a Form ATS with the SEC and is subject to FINRA's OATS and equity trade reporting rules. See 17 CFR 242.300(a)(1).

orders outside the ATS ("display ATS"), either to subscribers or through consolidated quote data, and ATSs that do not display orders outside the ATS ("non-display ATS").[10] A display ATS would also be required to indicate whether the order book is displayed to subscribers only, or distributed for publication in the consolidated quotation data.

Each ATS would also be required to indicate whether it is an ADF Trading Center as defined in Rule 6220, whether a specific order can be routed away from the ATS for execution, and whether there are any counter-party restrictions on the order. ATSs would also be required to provide FINRA with a unique identifier representing the specific order type.[11] ATSs will be required to provide FINRA with a list of all of their order types twenty days before the order types become effective, and if the ATS makes any subsequent changes to its order types, twenty days before the changes become effective, which will enable FINRA to map the identifier to a specific order type.[12]

An ATS also would be required to report, for all orders, the NBBO (or relevant reference price) in effect at the time of order receipt and the timestamp of when the ATS captured the effective NBBO (or relevant reference price); as part of this report, the ATS must identify the market data feed it used to obtain the NBBO (or relevant reference price). These two data elements will enable FINRA to ascertain if the NBBO changed between the time of order receipt

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For purposes of this rule, the term "order" includes a broker-dealer's proprietary quotes that are transmitted to an ATS.

[10] If an ATS meets the applicable volume thresholds, it is required to make its best bid and best offer available for publication in the consolidated quotation data. See 17 CFR 242.301(b)(3).

[11] This requirement would not apply to market and limit orders that have no other handling instructions.

[12] FINRA will provide a deadline prior to the implementation date by which current ATSs must submit lists of their existing order types. See Notice at 11851.

and the time the ATS captured the effective NBBO.[13]  Finally, each ATS would be required to

provide the sequence number assigned to the order event by the ATS's matching engine.

### Reporting requirements for execution of orders

The second category of proposed changes applies to all ATSs when reporting the

execution of an order to OATS.  Specifically, each ATS must record and report the NBBO (or

relevant reference price) in effect at the time of order execution, and the timestamp of when the

ATS captured the effective NBBO (or relevant reference price).  An ATS must identify the

market data feed used by the ATS to obtain the NBBO (or other reference price).[14]

### Reporting requirements for Display ATSs

The third category of changes applies only to display ATSs and requires that those ATSs

report the following order receipt information: (1) whether the order is hidden or displayable; (2)

display quantity; (3) reserve quantity, if applicable; (4) displayed price; and (5) the price entered.

If the matching engine re-prices a displayed order or changes the display quantity of a displayed

order, the ATS must report the time of the modification and the applicable new display price or

size.  FINRA stated that it needs this information from display ATSs to have an accurate, time

sequenced audit trail to reconstruct the displayed market and noted that the pricing and size

changes are being displayed to others.[15]

### Reporting requirements for ADF Trading Centers

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[13]     See Notice at 11852.

[14]     If for any reason, the ATS uses a feed other than the one that was reported on its ATS
data submission, the ATS must notify FINRA via email of the fact that an alternative
source was used, identify the alternative source, and specify the date(s), time(s) and
securities for which the alternative source was used.

[15]     See Notice at 11852.

Finally, FINRA proposed to require ADF Trading Centers to report the quote identifier provided to the ADF if a change to the displayed size or price of an order resulted in a new quote being transmitted to the ADF. If an order held by the ADF Trading Center becomes associated with a quote identifier based on an action by the matching engine related to a different order(s), (e.g., another order is cancelled making the order being held the best priced order in the matching engine), the ADF Trading Center must provide FINRA the new quote identifier.

III.  Comment Letter

The Commission received one comment letter[16] on the proposal and a response to the comment letter from FINRA.[17] The commenter suggested that FINRA amend the proposal to eliminate the requirement for ATSs to submit NBBO timestamp information to OATS.[18] The commenter sought clarification that the proposal does not require an ATS to report the time it actually received the NBBO, but would require the time the ATS's matching engine took the action to evaluate the NBBO after receiving or executing an order. According to the commenter, many ATS matching engines receive only the price changes in the NBBO, and not volume changes, to avoid unnecessary trading latency. Therefore, a comparison of the time the NBBO was received to the time of order receipt or execution could show significant time lag, which the commenter believes could give FINRA the impression that an ATS is not regularly updating its quotes.[19] In addition, with regard to the proposed requirement to identify the market data feed used by the ATS to record the NBBO (or other reference price), the commenter believes that FINRA should specify a list of market data feed types that should be used to populate the field,

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[16]  See supra, note 4.

[17]  See supra, note 5.

[18]  See SIFMA Letter at 1.

[19]  See id. at 2.

and that the best approach would be to designate general categories, such as "SIP," "direct," "hybrid," and "third party vendor."[20]

In its response to these comments, FINRA clarified that an ATS would comply with this NBBO timestamp requirement by reporting the time the ATS captured the NBBO, and not the time the ATS actually received the NBBO. In regard to the requirement to identify the market data feed used by the ATS to record the NBBO (or other reference price), FINRA stated that it will consider the commenter's suggestion when developing the technical specifications to implement the proposal.[21]

The commenter also suggested that FINRA eliminate the requirement to submit order type information to OATS and the corresponding requirement for ATSs to provide FINRA with advance notice of order types and changes.[22] The commenter stated that because the Commission has proposed new requirements for ATSs that trade NMS stocks,[23] including a requirement to provide advance notice of changes to order types, "FINRA should not use this proposal to get ahead of the Commission's final action."[24]

In its response to these comments, FINRA noted that the order type requirement set forth in its proposal is independent of the Commission's proposed action with respect to order types, and that FINRA has fully explained and justified its requirement in the proposal. FINRA stated that the reference to the Commission's proposed action was solely for background purposes. In

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[20]     See id.

[21]     See FINRA Response Letter at 3.

[22]     See SIFMA Letter at 3.

[23]     See Securities and Exchange Release No. 76474 (November 18, 2015), 80 FR 80998 (December 28, 2015). The Commission's proposal, among other things, would require ATSs to provide advance notice of material changes to the operation of an ATS, including changes to order types.

[24]     See SIFMA Letter at 3.

addition, FINRA believes that the 20-day advance notice requirement is consistent with current reporting obligations under Regulation ATS and thus would not increase the reporting burden on ATSs.[25]

Finally, the commenter requested clarification on technical reporting aspects of counter-party restrictions and sequence numbers.[26] Specifically, the commenter requested that FINRA clarify if ATSs must report counter-party restrictions on a "yes/no" basis or if specific counter-party restrictions must be reported. In addition, the commenter requested that FINRA clarify if ATSs must report the sequence number a specific ATS's matching engine assigns, or if all ATSs must adopt a uniform method of assigning sequence numbers.

In its response to these comments, FINRA clarified that the requirement to identify any counter-party restrictions is a yes or no response, and that the ATS would not be required to provide the specific counter-party restriction.[27] In addition, FINRA clarified that it is not mandating a particular or uniform format by which ATSs must report sequence numbers, and that requiring an ATS to report the sequence number as it currently exists in the ATS will satisfy this requirement.[28]

IV.     Discussion and Commission Findings

After careful review of the proposal, the comment letter received, and FINRA's response, the Commission finds that the proposed rule change is consistent with the requirements of the

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[25]     See FINRA Response Letter at 3.

[26]     See SIFMA Letter at 4.

[27]     See FINRA Response Letter at 4.

[28]     See id. at 4-5.

Act and the rules and regulations thereunder applicable to a national securities association.[29]  In

particular, the Commission finds that the proposed rule change is consistent with Section

15A(b)(6) of the Act,[30] 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 believes that the stated objectives of the proposal—to enhance

FINRA's ability to surveil activity occurring within an ATS, and by extension FINRA's ability

to surveil for potentially abusive algorithmic trading activity more generally across markets—are

consistent with the purposes of the Act and with FINRA's responsibility to enforce compliance

by its members with its rules and with the Act.  The additional information provided by ATSs

will better enable FINRA to reconstruct an ATS order book and more effectively conduct

quotation-based surveillance.  FINRA will integrate the additional information into its

surveillance patterns to support the generation and analysis of alerts, which will increase

FINRA's ability to detect a wide range of potential market-specific and cross-market

manipulative activities.

The Commission further believes that applying this proposal to NMS stocks is consistent

with the Act because the potentially abusive trading activity that the proposal is designed to

detect is of particular concern with respect to NMS stocks.  The Commission believes that gaps

in ATS order book data should be addressed in the near-term to ensure effective surveillance of

ATSs and, by extension, abusive algorithmic trading activity more generally across markets.

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[29]  In approving this proposed rule change, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation.  See 15 U.S.C. 78c(f).

[30]  15 U.S.C. 78o-3(b)(6).

The Commission believes that FINRA adequately responded to the issues raised in the comment letter.

Accordingly, for the reasons discussed above, the Commission finds that the proposed rule change is consistent with Section 15A of the Act.

V.    Conclusion

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act[31] that the proposed rule change (SR-FINRA-2016-010) be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[32]


Robert W. Errett
Deputy Secretary

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[31]    15 U.S.C. 78s(b)(2).

[32]    17 CFR 200.30-3(a)(12).