

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-91876; File No. SR-FINRA-2021-009)

May 12, 2021

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt a Supplemental Liquidity Schedule, and Instructions Thereto, Pursuant to FINRA Rule 4524 (Supplemental FOCUS Information)

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 April 30, 2021, the 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 adopt a Supplemental Liquidity Schedule, and Instructions thereto, pursuant to FINRA Rule 4524 (Supplemental FOCUS Information).

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 Statutory Basis for, the Proposed Rule Change

1. Purpose

FINRA Rule 4524 provides in part that, as a supplement to filing FOCUS Reports required pursuant to SEA Rule 17a-5³ and FINRA Rule 2010, each member, as FINRA shall designate, shall file such additional financial or operational schedules or reports as FINRA may deem necessary or appropriate for the protection of investors or in the public interest. Pursuant to FINRA Rule 4524, FINRA is proposing to adopt a Supplemental Liquidity Schedule (“SLS”), and Instructions thereto (the “Instructions”).⁴ The proposed SLS, which would be filed as a supplement to the FOCUS Report, is tailored to apply only to members with the largest customer and counterparty exposures, as discussed

³ 17 CFR 240.17a-5 (hereinafter cited as SEA “Rule 17a-5”). SEA Rule 17a-5 governs financial and operational reporting by brokers and dealers. Members are required to file with FINRA, through the eFOCUS System, reports concerning their financial and operational status using SEC Form X-17A-5 (the “FOCUS Report”). See, e.g., Information Notice, November 23, 2020 (2021 and First Quarter of 2022 Report Filing Due Dates); Regulatory Notice 18-38 (November 2018) (Amendments to the SEC’s Financial Reporting Requirements – eFOCUS System Updates and Annual Audit Requirements). “FOCUS” stands for Financial and Operational Combined Uniform Single.

⁴ The proposed SLS and Instructions are included as Exhibit 3 to this rule filing.

further below. The SLS is designed to improve FINRA's ability to monitor for events that signal an adverse change in the liquidity risk of the members that would be subject to the requirement.

Effective monitoring of liquidity and funding risks is an essential element of members' financial responsibility and an ongoing focus for FINRA's financial supervision programs. Liquidity and funding stress was a significant factor in the financial crisis of 2008.⁵ Since that time, FINRA has looked closely at members' liquidity and funding risk management practices.⁶ Regulatory Notice 10-57 expressed FINRA's expectation that members develop and maintain robust funding and liquidity risk management practices and discussed results of examinations that FINRA had conducted of the practices of selected members. In addition, Regulatory Notice 15-33 provided guidance on liquidity risk management practices and described FINRA's review of policies and practices at selected members related to managing liquidity needs in a stressed environment. FINRA believes that the proposed SLS is a logical complement to these ongoing priorities and guidance that FINRA has communicated to members and would provide essential information about members' sources and uses of

⁵ See, e.g., Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (January 2011), available at: <<https://fraser.stlouisfed.org/title/financial-crisis-inquiry-report-5034>>.

⁶ See Regulatory Notice 10-57 (November 2010) (Risk Management) and Regulatory Notice 15-33 (September 2015) (Liquidity Risk). However, even prior to the financial crisis, FINRA noted the importance of risk management practices. See, e.g., Notice to Members 99-92 (November 1999) (Risk Management Practices) (setting forth a joint statement by the SEC, NASD and NYSE on broker-dealer risk management practices). FINRA has also discussed liquidity risk in its Annual Regulatory and Examination Priorities Letters. See, e.g., 2019 Annual Risk Monitoring and Examination Priorities Letter, available at: <finra.org>.

liquidity to enable FINRA to better understand their liquidity profile. FINRA notes that events in connection with market volatility and other stress stemming from the COVID-19 pandemic,⁷ and events such as the extreme price volatility of certain stocks in January 2021,⁸ have reinforced the importance of effective liquidity risk monitoring. As such, FINRA believes that the proposed SLS is necessary to enhance its ongoing monitoring of members' liquidity risk and to have additional information that can be used to assess the impact of stress events on a member's liquidity. Members that would be subject to the SLS requirement would provide detailed reporting, using the SLS, as to their:

- reverse repurchase and repurchase agreements;
- securities borrowed and securities loaned;
- non-cash reverse repurchase and securities borrowed transactions;
- non-cash repurchase and securities loaned transactions;
- bank loan and other committed and uncommitted credit facilities;
- total available collateral in the member's custody;
- margin and non-purpose loans;
- collateral securing margin loans;
- deposits at clearing organizations; and

⁷ See, e.g., S.P. Kothari et al., U.S. Credit Markets: Interconnectedness and the Effects of the COVID-19 Economic Shock (October 2020) (report of the SEC Division of Economic and Risk Analysis regarding market stress during the COVID-19 shock of March 2020), available at: <https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf>.

⁸ See Acting Chair Allison Herren Lee, Commissioners Hester M. Peirce, Elad L. Roisman, and Caroline A. Crenshaw, Public Statement Regarding Recent Market Volatility (January 29, 2021), available at: <<https://www.sec.gov/news/public-statement/joint-statement-market-volatility-2021-01-29>>.

- cash and securities received and delivered on derivative transactions not cleared through a central clearing counterparty (“CCP”).

In developing the proposed SLS, FINRA has engaged in extensive outreach and discussions with industry participants. In January 2018, FINRA published an earlier version of the proposed SLS for comment⁹ and, as discussed further below, in response to comments, and based on dialogue with and feedback from industry participants, has tailored and clarified the proposed SLS and Instructions. Under the proposed SLS, unless otherwise permitted by FINRA in writing, the SLS would be required to be filed by each carrying member with \$25 million or more in free credit balances, as defined under SEA Rule 15c3-3(a)(8),¹⁰ and by each member whose aggregate amount outstanding under repurchase agreements, securities loan contracts and bank loans is equal to or greater than \$1 billion, as reported on the member’s most recently filed FOCUS report. The SLS must be completed as of the last business day of each month (the “SLS date”) and filed within 24 business days after the end of the month. A member need not file the SLS for any period where the member does not meet the \$25 million or \$1 billion thresholds.¹¹

⁹ See Regulatory Notice 18-02 (January 2018) (Liquidity Reporting and Notification).

¹⁰ 17 CFR 240.15c3-3 (hereinafter cited as SEA “Rule 15c3-3”).

¹¹ FINRA notes that members that have elected to be treated as capital acquisition brokers (“CABs”) would be subject to the rule change to the extent that FINRA Rule 4524, pursuant to CAB Rule 452(b), applies to CABs. However, the proposed rule change would unlikely impact CABs. The proposed \$25 million free credit balances threshold applies to carrying members and as such would not affect CABs because, pursuant to CAB Rule 016(c)(2), CABs are prohibited among other things from carrying customer accounts, or from holding or handling customer funds or securities. With respect to the proposed \$1 billion threshold, FINRA believes that it is unlikely any CABs would meet this level of financing given the limited nature of their business under the CAB rules.

FINRA notes that, with these \$25 million and \$1 billion thresholds, the proposal would apply to approximately 85 to 100 members that have the largest customer and counterparty exposures, and as such, is tailored to apply to members whose liquidity events could have the greatest potential impact on customers, counterparties, and markets.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 30 days following Commission approval. The effective date will be no later than 180 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

The proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹² 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. Consistent with the provisions of the Act, the proposed rule change will enable FINRA to more effectively monitor the liquidity risk of members with the largest customer and

The proposed rule change would not apply to funding portal members because such members are not subject to Rule 4524. Even if Rule 4524 were to apply, the rule change would unlikely affect funding portal members because, pursuant to Regulation Crowdfunding Rule 300(c)(2)(iv), such members are prohibited from holding, possessing, managing or otherwise handling investor funds or securities. Further, again by virtue of the limited nature of their business, funding portal members are unlikely to meet the proposed \$1 billion threshold.

¹² 15 U.S.C. 78q-3(b)(6).

counterparty exposures, thereby enhancing FINRA's ability to supervise the financial responsibility of larger member firms and maintain investor protection.

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. The proposed SLS is designed to improve FINRA's ability to monitor liquidity risk of the members that would be subject to the requirement and provide additional warning of market stress. FINRA has designed the proposed SLS to achieve its intended and necessary regulatory purpose while minimizing the burden on firms. Ready access to the information is important for FINRA to efficiently monitor on an ongoing basis the liquidity profile of members. In particular, the information would facilitate FINRA's efforts to understand and respond to firms that may appear similar based on their balance sheet, but in fact have different liquidity risk profiles, which could negatively impact their ability to fund their operations during periods of market or other stress events. In the absence of this reporting requirement, FINRA would need to request this information repeatedly on a firm-by-firm basis as need arises, resulting in similar, or even potentially larger, costs for the firms.

FINRA notes that, as discussed above, the proposal would apply to approximately 85 to 100 members that meet the thresholds as defined by the proposal. Given that these firms have the largest customer and counterparty exposures, they are likely to have the largest potential liquidity risk, to which the proposed SLS is aimed at providing increased monitoring and transparency. The underlying information required to complete the

proposed SLS should be readily available to members due to members' obligations to maintain books and records for those items required to be reported on the SLS.

FINRA further notes that out of the approximately 85 to 100 firms for which the proposal would apply to, about one quarter of those are members of large bank holding companies ("BHCs"). This subset of firms are required to provide similar information in reporting at the BHC and material entity level to the Federal Reserve Board.¹³ FINRA believes that the threshold for the SLS reporting requirement may result in some competitive effects, for firms that fall above or below the reporting threshold, in addition to firms that do and do not report overlapping information through the FR 2052a report. However, the overall direction of these effects is not clear, and FINRA does not believe the effects are significant when weighed against the value of the SLS report. FINRA has reviewed in this regard the information requested by the proposed SLS versus the information requested by the FR 2052a report. A broker-dealer that is a material entity within a BHC may report some of the same information under this proposal that the broker-dealer provides for purposes of the FR 2052a report.¹⁴ To the extent there is some overlap in reporting, FINRA expects that additional costs from providing the information for purposes of the SLS would be minimal. These firms should be able to rely on their existing compliance systems and infrastructure for the reporting of these items. However, some costs are anticipated due to differences in the information required for the

¹³ This reporting is done using the Complex Institution Liquidity Monitoring Report (FR 2052a) (hereinafter referred to as the "FR 2052a report"), available at: <<https://www.federalreserve.gov/apps/reportforms/default.aspx>>.

¹⁴ The instructions to the FR 2052a report provide that ". . . each material entity required to report will report on a consolidated basis," except as otherwise specified in the instructions.

two reports and differences in the frequency of the reporting. Where this reporting is not duplicative, firms will incur some start-up costs to establish the reporting system and then ongoing costs in providing the information, and the relevant supervisory and compliance systems. In contrast, firms that are not within a BHC will incur new start-up costs that may be greater than the incremental start-up costs of firm within a BHC, while firms below the threshold will not incur these costs. Nonetheless, FINRA believes the thresholds are well tailored to require disclosure from firms whose liquidity impacts substantially outweigh the collection and reporting costs of the SLS.

C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published for comment in Regulatory Notice 18-02 (January 2018) (the “Notice”). Three comments were received in response to the Regulatory Notice.¹⁵ Exhibit 2a is a copy of the Regulatory Notice. Exhibit 2b contains copies of the comment letters received in response to the Regulatory Notice. Below is a summary of the comments and FINRA’s responses.

In the Notice, in addition to seeking comment on a proposed earlier version of the SLS, FINRA sought comment on proposed amendments to FINRA Rule 4521 (Notifications, Questionnaires and Reports) that would have imposed additional requirements on members subject to the SLS to notify FINRA no more than 48 hours

¹⁵ See Letter from Allen Riggs, CFO, Vining Sparks IBP, L.P., to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated February 21, 2018 (“Vining Sparks”); Letter from Jon Zindel, Chief Financial Officer, William Blair & Company, LLC, to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated March 7, 2018 (“William Blair”); and Letter from Mary Kay Scucci, Managing Director, Securities Industry and Financial Markets Association, to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated March 8, 2018 (“SIFMA”).

after specified events that may signal an adverse change in liquidity risk. Most of the concerns expressed by commenters focused on these proposed amendments to Rule 4521. In particular, SIFMA and Vining Sparks expressed concern that the proposed amendments were complex and operationally burdensome, were in need of further clarification, should be tailored to permit members to use models specific to their firms, or should be aligned or coordinated with potential future Commission action in the area of broker-dealer liquidity and risk monitoring. In response, FINRA notes that it has been engaging, and plans to continue to engage, with industry participants and with other regulators with regard to these concerns and will give further consideration as to potential rule changes to address effective liquidity monitoring. As such, FINRA is not at this time proposing amendments to Rule 4521 as part of the proposed rule change.

With regard to the proposed SLS as originally proposed in the Notice, all three commenters suggested clarifications and revisions. William Blair and Vining Sparks expressed concern that, because the \$25 million threshold as proposed in the Notice would have been based on “total credits” under Exhibit A of Rule 15c3-3, smaller firms that engage mostly in institutional trades on a delivery versus payment/receive versus payment (“DVP/ RVP”) basis would fall within the proposed requirement by virtue of the credits they are obliged to report in connection with “failed to receive” transactions. Commenters believed this would include firms whose business activities do not present significant liquidity risk in the SLS reporting requirement. In response, FINRA has engaged with industry participants and has revised the \$25 million threshold to reference “free credit balances” as defined under SEA Rule 15c3-3(a)(8). FINRA believes that referencing free credit balances for the \$25 million threshold more directly identifies

firms that should be subject to the SLS and is consistent with FINRA's intent to reach only members with the highest potential liquidity risk. As discussed above, the proposal would apply to approximately 85 to 100 firms, generally FINRA's largest members, which is the appropriate scope in light of its regulatory purpose. Vining Sparks expressed concern that the SLS, as originally proposed in the Notice, would require disclosure of the names of the reporting member's top five counterparties for certain of the specified categories of information, which Vining Sparks suggested could raise privacy and confidentiality concerns. In response, FINRA has revised the Instructions to the proposed SLS so that members would have the option to specify a counterparty type or name in the portions of the SLS that request top five counterparty information. FINRA believes that permitting members this flexibility is appropriate because specifying counterparty types rather than counterparty names achieves the overall goal of helping to understand and monitor the impact from counterparties on the liquidity profile of the member submitting the SLS. Further, FINRA notes that it has the ability to request further information as to any counterparty transaction should such be warranted.

SIFMA expressed concern that the purpose of and need for the SLS as proposed in the Notice is unclear, that the SLS would require the disclosure of information that should be kept confidential, that the proposal is duplicative of requirements that apply to firms that are already part of BHCs, that the proposal should not go forward until the SEC acts in the area of liquidity monitoring, and that the information required on the proposed SLS is unhelpful or unnecessary to understanding a firm's liquidity or is operationally burdensome to track. FINRA engaged with industry participants and SIFMA to discuss these concerns.

FINRA believes that the purpose of, and regulatory need for, the proposal, as set forth in the Notice and as reiterated in this filing, is clear. To address the concerns expressed by commenters with regard to the potential burdens of the proposal, FINRA, based on extensive discussions with industry participants, has made several revisions to the proposed SLS. For example, FINRA has revised the proposed SLS so that members with de minimis total reverse repurchase or repurchase agreements may elect not to complete the securities collateral subcategories in Lines 1 through 5 under Reverse Repurchase and Repurchase Agreements, and may elect not to complete the Top Five Counterparties portion that corresponds with that section.¹⁶ As revised, also under the Reverse Repurchase and Repurchase Agreements section, the proposed SLS would permit members flexibility to allocate contracts collateralized by more than two security types among those types of collateral for purposes of their reporting. With regard to reporting counterparties, FINRA has revised the SLS so that members electing to report counterparties by type rather than by name will be permitted to use the counterparty classifications and definitions given in the FR 2052a report, thereby helping members in BHCs align their SLS reporting with the FR 2052a report. Similarly, FINRA has added language to the proposed SLS designed to align reporting for non-cash and collateral upgrade transactions with members' other regulatory reporting.¹⁷

¹⁶ Members would need to complete Lines 6a, 6b, 6c and 7, as applicable. FINRA has made a corresponding revision to the Securities Borrowed and Securities Loaned section.

¹⁷ FINRA has made additional miscellaneous revisions to the SLS designed to clarify categories in the Instructions such as “term loans” and “deposits at clearing organizations.” Further, in the Instructions, FINRA has also revised the Bank Loan and Other Committed and Uncommitted Credit Facilities section to clarify

SIFMA requested that FINRA further clarify the reporting date for the SLS, and suggested that data should be reported as of month-end. In response, FINRA has revised the SLS to provide that the SLS must be completed as of the last business day of each month (as noted above, the SLS date) and filed within 24 business days after the end of the month. FINRA notes the 24 business days is meant to afford members additional time to file versus the 22 business days as proposed in the Notice. SIFMA requested clarification as to who within a member would be responsible for completing the proposed SLS. In response, it is not FINRA's intention to impose an additional potential burden by designating specific persons within the firm that would need to complete the SLS. Given the SLS is intended as a supplement to the FOCUS reporting for which a member is already responsible, FINRA understands that members may handle the SLS as a financial and operational report consistent with their FOCUS and other financial-related reporting processes and obligations.

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 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.

that Line 4 under that section (Drawn Amounts of Uncommitted Credit Facilities) includes, for example, commercial paper.

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-2021-009 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2021-009. 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 a.m. and 3

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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2021-009 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.¹⁸

J. Matthew DeLesDernier
Assistant Secretary

¹⁸ 17 CFR 200.30-3(a)(12).