

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-70048; File No. SR-FINRA-2013-031)

July 26, 2013

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change Relating to Participation on the Alternative Display Facility

Pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (the “Act”)² and Rule 19b-4 thereunder,³ notice is hereby given that, on July 18, 2013, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. 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 Rules 6271 and 6272 regarding the requirements for members seeking registration as FINRA Alternative Display Facility (“ADF”) Market Participants.

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.

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

¹ 15 U.S.C.78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

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

(1) ADF Background

The ADF is a quotation collection and trade reporting facility. It provides ADF Market Participants (i.e., ADF-registered market makers or electronic communications networks (“ECNs”))⁴ the ability to post quotations or display orders in NMS stocks and provides all member firms that participate in the ADF the ability to view quotations and report transactions in NMS stocks to the Securities Information Processors (“SIPs”) for consolidation and dissemination of data to vendors and ADF Market Participants. In addition, the ADF delivers real-time data to FINRA for regulatory purposes, including enforcement of requirements imposed by Regulation NMS.⁵

The ADF was initially approved by the Commission on July 24, 2002, in connection with the SEC’s approval of SuperMontage and Nasdaq’s registration as a national securities exchange.⁶ At that time, the ADF was approved for Nasdaq-listed securities for a nine-month pilot period to provide FINRA members with an alternative to the Nasdaq systems for reporting quotations and transactions in Nasdaq UTP Plan securities. On September 28, 2006, the SEC

⁴ See FINRA Rule 6220(a)(3).

⁵ See 17 CFR 242.600.

⁶ See Securities Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49822 (July 31, 2002); see also NASD Notice to Members 02-45 (August 2002).

approved amendments to extend the ADF's functionality to all NMS stocks.⁷ The ADF was approved on a permanent basis for NMS stocks on January 26, 2007.⁸

(2) Current ADF Registration Requirements

Similar to rules applicable to exchange market makers, ADF Market Participants (i.e., either Registered Reporting ADF Market Makers or Registered Reporting ADF ECNs)⁹ must register as ADF market makers or ECNs before making a market or displaying orders on the ADF.¹⁰ Members are required to register as ADF Market Participants by applying to FINRA, which includes certifying the member's good standing with FINRA and demonstrating compliance with the net capital and other financial responsibility provisions of the Act.¹¹ Before displaying quotations or orders on the ADF, ADF Trading Centers¹² must also execute and comply with a Certification Record to certify the ADF Trading Center's compliance efforts with its obligations under Regulation NMS.¹³

(3) Status of the ADF and Other FINRA Transparency Facilities

Since the ADF was launched in 2002, no member has registered with FINRA as a Registered Reporting ADF Market Maker, and there have been four members that, at various

⁷ See Securities Exchange Act Release No. 54537 (September 28, 2006), 71 FR 59173 (October 6, 2006); see also NASD Notice to Members 06-67 (November 2006).

⁸ See Securities Exchange Act Release No. 55181 (January 26, 2007), 72 FR 5093 (February 2, 2007).

⁹ See FINRA Rule 6220(a)(3), (12), (13).

¹⁰ See FINRA Rule 6271.

¹¹ See FINRA Rule 6271(b).

¹² An "ADF Trading Center" is a Registered Reporting ADF Market Maker or Registered Reporting ADF ECN that is a "Trading Center," as defined in Rule 600(b)(78) of SEC Regulation NMS, and that is certified to display its quotations or orders through the ADF. See FINRA Rule 6220(a)(4); see also 17 CFR 242.600(b)(87).

¹³ See FINRA Rules 6220(a)(5), 6250(a)(7); NASD Notice to Members 06-67 (November 2006); see also SR-NASD-2006-091, Exhibit 3.

points in time, were registered as Registered Reporting ADF ECNs.¹⁴ Since the second quarter of 2010, there have been no ADF Market Participants.

Beginning in 2011, FINRA began the process of updating and migrating all of its transparency facilities (including the FINRA Trade Reporting Facilities, the Trade Reporting and Compliance Engine (“TRACE”), and the ADF) off of independent technology platforms and onto a new, single, updated technology platform known as the Multi Product Platform (“MPP”).¹⁵ Due to the enormous scope of this project, FINRA was required to prioritize and migrate each facility sequentially. Because there have been no ADF Market Participants since March of 2010, the migration of the ADF onto MPP was scheduled to be undertaken last, which would result in the new ADF base platform being migrated to MPP and ready for onboarding of a new ADF Market Participant no sooner than mid-2014. However, even after the ADF is migrated to MPP, FINRA will only have the ADF base infrastructure completed; further specific build-outs, estimated to take approximately six months, are necessary to accommodate an individual ADF Market Participant seeking to quote on or report trades to the ADF. To determine the specific build-outs necessary to support a new ADF Market Participant, a member would need to provide FINRA with estimated volume projections of quotation and trade reporting activity that would flow through the ADF.

Recently, several members have approached FINRA to discuss the possibility of becoming an ADF Market Participant, and some have asked whether the migration of the ADF to MPP could be accelerated. As discussed more fully below, the timeframe to bring the new ADF

¹⁴ The four former Registered Reporting ADF ECNs are: (i) LavaFlow, (ii) Instinet, (iii) Track Data Securities Corp, and (iv) Direct Edge. See www.finra.org/Industry/Compliance/MarketTransparency/ADF/Participants/.

¹⁵ FINRA’s TRACE facility for reporting transactions in fixed-income securities has been migrated to MPP. See Regulatory Notice 11-53 (November 2011). The FINRA / NYSE TRF was migrated onto MPP as of October 1, 2012.

base infrastructure live can be accelerated in the MPP rollout schedule. However, to do so necessarily means delaying the migration of other FINRA facilities onto MPP, reallocating resources, shifting scheduling, and implementing ADF-specific enhancements and hosting in the new technology environment - all of which impose significant costs on FINRA, including prolonging the substantially higher expenses associated with the legacy OTC Equity Trade Reporting Facility (“ORF”) infrastructure (i.e., legacy ORF support costs are significantly higher than the expected costs of supporting the ORF in the new MPP technology environment).

In addition to the costs of accelerating the migration of the ADF onto MPP, bringing the new ADF base infrastructure live in the MPP technology environment to accommodate an ADF Market Participant will impose significant direct costs on FINRA related to building and testing the new ADF component on the MPP infrastructure and also related to paying for SIP capacity usage allocations. Consuming real time data feeds for ADF system price validation and other purposes will impose additional costs. General staff labor, support, and testing will impose related costs on FINRA as well. In aggregate, the MPP component re-sequencing necessary to accommodate ADF acceleration and the costs associated with bringing the ADF base infrastructure live will conservatively cost FINRA in excess of \$3 million.

If the ADF MPP launch is accelerated, FINRA believes an ADF Market Participant could be live on the ADF by the end of 2013. If the ADF MPP launch is not accelerated, FINRA intends to have the ADF base infrastructure prepared for a participant by mid-2014, and a participant could be live on the ADF at the earliest six months after the base layer functionality is complete (i.e., approximately late 2014 or early 2015).

(4) Proposed Amendments to the ADF Rules

The proposed rule change would consolidate into a single rule (FINRA Rule 6271) the existing requirements that a member must meet to register as an ADF Market Participant and introduce new requirements that potential ADF Market Participants must meet to participate on the ADF. These new requirements are intended to mitigate the substantial financial risks to FINRA, discussed above, of accelerating the migration of the ADF onto MPP or of building out the ADF base platform to accommodate an ADF Market Participant.

As amended by the proposed rule change, FINRA Rule 6271 would specify that a member seeking registration as an ADF Market Participant must (i) file an application with FINRA, (ii) execute the Certification Record, and (iii) execute a Participant Agreement. Rule 6271(a)(1) would require a potential ADF Market Participant to file an application with FINRA in which the member:

- specifies whether the member is seeking registration in Nasdaq and/or CQS securities;
- certifies the member's good standing with FINRA;
- demonstrates compliance with the net capital and other financial responsibility provisions of the Exchange Act;
- provides FINRA with reasonable monthly projections of the volume of data that the member anticipates submitting to the ADF;
- agrees to submit the ADF Deposit Amount¹⁶ in five equal installments into an escrow account at a bank mutually acceptable to the member and FINRA on a timetable as agreed to by the member and FINRA;

¹⁶ As described more fully below, the ADF Deposit Amount is \$250,000; however, the

- agrees that failing to submit quotes and report trades to the ADF for a term of two years will result in the forfeiture of some or all of the ADF Deposit Amount;
- agrees that failing to submit 75% of both its quote and trade volume in NMS stocks will result in the forfeiture of some or all of the ADF Deposit Amount; and
- agrees to the other ADF Deposit Terms, which are the same for all members and are described below.

The first three requirements of the application, which specify whether the member is seeking registration in Nasdaq and/or CQS securities, certify the member's good standing with FINRA, and demonstrate compliance with the net capital and other financial responsibility provisions of the Act, are the same as the requirements currently in Rule 6271(b). Members who are Trading Centers, as defined in Rule 600(b)(78) of SEC Regulation NMS,¹⁷ are also currently required to execute and comply with an ADF Certification Record, in which the member agrees, among other things, to abide by the requirements of Regulation NMS.¹⁸ The proposed rule change would add this existing requirement into Rule 6271 so that all registration requirements are located in a single rule.¹⁹

The proposed rule change would add several new requirements into the application that members must complete to become ADF Market Participants. The new provisions require that a member seeking to become an ADF Market Participant: (i) provide FINRA with reasonable monthly projections of the volume of data that the member anticipates submitting to the ADF;

amount will be increased to \$500,000 under certain circumstances.

¹⁷ 17 CFR 242.600(b)(78).

¹⁸ See FINRA Rules 6220(a)(5), 6250(a)(7).

¹⁹ The proposed rule change also moves the provision requiring registration in order to participate on the ADF from Rule 6271 to Rule 6272 with no substantive change.

(ii) agree to submit the ADF Deposit Amount in five equal installments into an escrow account at a bank mutually acceptable to the member and FINRA on a timetable as agreed to by the member and FINRA; (iii) agree that failing to submit quotes and report trades to the ADF for a two-year period will result in the forfeiture of some or all of the ADF Deposit Amount; (iv) agree that failing to submit 75% of the member's trade and quote volume in NMS stocks to the ADF will result in the forfeiture of some or all of the ADF Deposit Amount; and (v) agree to the other ADF Deposit Terms set forth in the rule.

The new provisions are intended to ensure that FINRA can recover a portion of the costs associated with accelerating the migration of the ADF to MPP and bringing a new ADF Market Participant onto the ADF if the ADF Market Participant fails to participate on the ADF as anticipated. As noted above, FINRA is currently in the process of creating a new ADF platform as part of its efforts to migrate all FINRA facilities onto MPP. Under the current timeframe, the ADF base infrastructure is scheduled to be available on the new platform by no sooner than mid-2014; however, it is possible for FINRA to rearrange the scheduling priority and have the ADF available for new ADF Market Participants potentially as early as late-2013. As described above, altering the timetable imposes significant costs on FINRA associated with delaying the retirement of other products, diverting effort and resources from the current MPP roll-out schedule, and delaying the termination of other product legacy fee structures. Moreover, as noted above, even after the base infrastructure for the ADF is otherwise completed, the transition of an ADF Market Participant onto the MPP infrastructure will impose substantial development costs and staff effort costs on FINRA. The new provisions set out in the proposed rule change are intended to ensure that FINRA will be able to recover a portion of the costs incurred as a result of accommodating a member's request to accelerate the migration of the ADF to MPP or

building out the ADF platform to accommodate the member's volume projections should the member fail to participate on the ADF as anticipated.

Pursuant to the proposed rule change, potential ADF Market Participants must provide FINRA with reasonable monthly projections of the volume of data that the member anticipates submitting to the ADF. In addition, the potential ADF Market Participant must agree to quote on and report trades to the ADF for a two-year term and to submit at least 75% of both its quote and trade volume to the ADF. If the ADF Market Participant fails to meet one of these obligations, it will forfeit some or all of the ADF Deposit Amount. These requirements serve two primary purposes: (1) they provide FINRA the information necessary to ensure the ADF can accommodate the volume of data the member anticipates submitting to the ADF and (2) they establish the basis upon which FINRA will be safeguarded by ensuring that the potential ADF Market Participant will bear some of the financial responsibility should FINRA undertake the efforts and incur the costs necessary to bring the ADF Market Participant onto the ADF, only to have the ADF Market Participant fail to participate at all or at the level agreed to.

To ensure the volume commitments are met, the proposed rule change requires potential ADF Market Participants to agree to submit an "ADF Deposit Amount" in five equal installments into an escrow account at a bank mutually acceptable to the member and FINRA on a timetable as agreed to by the member and FINRA. The proposed rule change defines the "ADF Deposit Amount" as \$500,000 if the member requests that FINRA accelerate the ADF migration or if the member begins quoting on or reporting trades to the ADF within 90 calendar days after an ADF Market Participant that requested acceleration of the ADF migration begins quoting on or reporting trades to the ADF. For all other ADF Participants, the ADF Deposit Amount is \$250,000.

FINRA is proposing to establish the two separate levels of the ADF Deposit Amount referenced above in order to reflect the differing costs FINRA will incur under either of two scenarios. Because FINRA will incur significantly higher costs if the migration of the ADF is accelerated at a member's request, FINRA has proposed an ADF Deposit Amount of \$500,000 should the member request such acceleration. Additionally, to ensure that ADF Market Participants benefitting from an acceleration of the ADF onto MPP are treated equally, FINRA proposes to charge \$500,000 to any member that begins quoting on or reporting trades to the ADF within ninety (90) days after an existing ADF Market Participant that requested acceleration of the ADF migration begins quoting on or reporting trades to the ADF. FINRA believes that this amount, which, as noted above, is substantially lower than the actual costs FINRA will incur by amending the current MPP migration schedule reflects an appropriate balance between ensuring that FINRA is able to recover a portion of the costs associated with an accelerated migration while not representing a significant financial barrier to participation on the ADF, particularly since members can potentially recover 100% of the ADF Deposit Amount over the two-year term and up to 80% of the ADF Deposit Amount in the first quarter of their participation on the ADF through the credit structure for market data revenue described below. Moreover, FINRA believes that permitting potential participants to earn back the entire deposit amount is more equitable than charging potential ADF Market Participants a one-time payment without the ability to recover some, or all, of the amount.

The proposed rule change would reduce the ADF Deposit Amount to \$250,000 if the member has not requested an accelerated migration or does not become an ADF Market Participant within 90 days after another ADF Market Participant that had requested acceleration (i.e., paid an escrow amount of \$500,000) begins quoting on or reporting trades to the ADF. The

lower amount reflects the fact that the costs to FINRA are significantly reduced under these circumstances because the ADF base platform will have already been migrated to MPP. However, although reduced, FINRA anticipates such costs will still be significantly higher than the \$250,000 deposit amount in such a scenario based on costs related to possible additional hardware and software deployments, paying for SIP capacity usage allocations, and costs related to general staff labor, support and testing.

FINRA notes that the ADF Deposit Amount will be the same for any member seeking to become an ADF Market Participant, regardless of the member's overall anticipated quotation and trading volume. Because the costs incurred by FINRA to migrate the ADF and to build it out do not vary significantly as a result of the volume of the ADF Market Participant's trading activity, FINRA believes it is fair and equitable to require each prospective ADF Market Participant to submit the same amount into escrow.

The proposed rule change includes several required terms for the handling of the ADF Deposit Amount (referred to as "ADF Deposit Terms"), including the methods for ADF Market Participants to recover some or all of the ADF Deposit Amount as a result of meeting its participation commitments (or due to FINRA's inability to meet its obligations) and methods for FINRA to receive the funds if commitments are not met. The proposed rule change retains some flexibility in the precise terms of any agreements between FINRA and potential ADF Market Participants to ensure that any unique circumstances can be addressed by permitting de minimis additions or qualifications to the ADF Deposit Terms, provided both FINRA and the member agree to those additions or qualifications.

The proposed rule change includes a means for ADF Market Participants to earn back the ADF Deposit Amount. Specifically, the proposed rule change provides that for every \$1.00

received by FINRA from the National Market System (“NMS”) SIP data plans associated with ADF activity attributable, as determined in FINRA’s sole discretion, to the member’s trading activity on the ADF, the member shall receive \$0.50 out of the escrow account. Thus, in essence, an ADF Market Participant will recover an amount equal to one-half of the SIP market data revenue generated by the ADF Market Participant’s trading activity on the ADF. The ADF Market Participant’s recovery would be paid on a quarterly basis after FINRA has received its quarterly disbursement from the NMS SIP data plans.²⁰ This provides for a reasonable opportunity for FINRA to recover some of its costs of re-sequencing the MPP rollout by virtue of the SIP market data revenue split.

In addition, the proposed rule change provides that the ADF Market Participant is only entitled to receive an amount up to 80% of the ADF Deposit Amount pursuant to this provision and is not entitled to the remaining 20% of the ADF Deposit Amount until the end of the two-year term, assuming its trading activity has earned the requisite market data revenue from the SIPs. To the extent that the ADF Market Participant opts to stop participating on the ADF before the end of the two-year term or stop meeting its volume commitment before the end of the two-year term (i.e., chooses to quote or trade through another trading venue), it would be free to do so but could potentially forfeit some or all of the remaining ADF Deposit Amount.

If FINRA does not make the ADF available within nine months of an ADF Market Participant’s first deposit of the ADF Deposit Amount into the escrow account, one-fifth of the ADF Deposit Amount will be released from such escrow account to the ADF Market Participant. An additional one-fifth of the initial ADF Deposit Amount will be released to the ADF Market

²⁰ Charges or credits as a result of SIP audit recoveries, which typically are de minimis as compared to the overall revenue paid, would not be included in the calculation.

Participant every month thereafter that FINRA has not made the ADF available, until all funds have been released from such escrow account.

The proposed rule change also includes provisions designed to protect FINRA if a member requests that the ADF be migrated to MPP on an accelerated basis or if FINRA undertakes efforts to build out the system to support the member, and in either instance, the member fails to participate. The proposed rule change provides that one-fifth of the ADF Deposit Amount shall be released to FINRA if, in any calendar month beginning with the fourth calendar month following certification of the ADF Market Participant to quote on or report trades to the ADF, the ADF Market Participant fails to submit 75% of the member's quoting and trade reporting activity to the ADF. In addition, if a member is sold (other than a sale to an entity that would otherwise meet the FINRA qualifications as an ADF Market Participant), goes out of business, otherwise does not meet its obligations, or fails to complete the process for becoming an ADF Market Participant, the member will forfeit the ADF Deposit Amount, or any lesser amount remaining in the escrow account, and all funds will be released from such escrow account to FINRA.

Finally, the proposed rule change would make clear that a member would become an ADF Market Participant only after (i) the member received a notice of approval from FINRA that its application was accepted, (ii) the member executed the Certification Record, and (iii) FINRA executed the Participant Agreement.

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 30 days following publication of the Regulatory Notice announcing 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,²¹ 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 and Section 15A(b)(5) of the Act,²² which requires, among other things, that FINRA rules provide for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system that FINRA operates or controls. FINRA believes that the proposed rule change establishes an equitable and transparent method for registering members for participation on the ADF. FINRA also believes that requiring individual members to ensure the recoupment of a portion of the specific costs FINRA incurs to accommodate their request to accelerate the migration of the ADF or use the ADF is a fair and equitable way to ensure that the members responsible for those costs are accountable should they not participate on the ADF to the extent anticipated.

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 that members that choose to use the ADF should bear responsibility for costs incurred in accelerating the ADF's migration or in otherwise building out the ADF. The decision to request acceleration or to use the ADF to display quotations or orders lies solely with the member. Further, members are able to recover the full amount of their ADF Deposit Amount by meeting the terms of the agreement. Although a member would be required to provide a

²¹ 15 U.S.C. 78o-3(b)(6).

²² 15 U.S.C. 78o-3(b)(5).

commitment to quote on and report trades to the ADF, it always retains the option to leave the ADF or choose to quote or trade through another trading venue, but must bear certain financial consequences associated with that choice.

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 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 shall: (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 Number SR-FINRA-2013-031 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 Number SR-FINRA-2013-031. 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 the filing will also 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-2013-031 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.²³

Kevin M. O'Neill
Deputy Secretary

²³ 17 CFR 200.30-3(a)(12).