

Required fields are shown with yellow backgrounds and asterisks.

| | | | |
|----------------|--|-----------------------------|---------------------------------------|
| Page 1 of * 28 | SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4 | File No.* SR - 2020 - * 002 | Amendment No. (req. for Amendments *) |
|----------------|--|-----------------------------|---------------------------------------|

Filing by Financial Industry Regulatory Authority
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

| | | | | | |
|--|--|--|--|--|---|
| Initial * <input checked="" type="checkbox"/> | Amendment * <input type="checkbox"/> | Withdrawal <input type="checkbox"/> | Section 19(b)(2) * <input type="checkbox"/> | Section 19(b)(3)(A) * <input checked="" type="checkbox"/> | Section 19(b)(3)(B) * <input type="checkbox"/> |
| | | | Rule | | |
| Pilot <input type="checkbox"/> | Extension of Time Period for Commission Action * <input type="checkbox"/> | Date Expires * <input type="text"/> | <input type="checkbox"/> 19b-4(f)(1) | <input type="checkbox"/> 19b-4(f)(4) | |
| | | | <input type="checkbox"/> 19b-4(f)(2) | <input type="checkbox"/> 19b-4(f)(5) | |
| | | | <input type="checkbox"/> 19b-4(f)(3) | <input checked="" type="checkbox"/> 19b-4(f)(6) | |

| | |
|---|--|
| Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 | Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 |
| Section 806(e)(1) * <input type="checkbox"/> | Section 806(e)(2) * <input type="checkbox"/> |
| Section 3C(b)(2) * <input type="checkbox"/> | |

| | |
|--|--|
| Exhibit 2 Sent As Paper Document <input type="checkbox"/> | Exhibit 3 Sent As Paper Document <input type="checkbox"/> |
|--|--|

Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed rule change to amend Rule 11900 (Clearance of Corporate Debt Securities) to except certain transactions in corporate debt securities

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * Racquel Last Name * Russell

Title * Associate General Counsel

E-mail * racquel.russell@finra.org

Telephone * (202) 728-8363 Fax (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title *)

Date 01/17/2020

By Stephanie Dumont

Senior Vice President and Director of Capital Markets Policy

Stephanie Dumont,

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

Form 19b-4 Information *

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies *

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ Financial Industry Regulatory Authority, Inc. (“FINRA”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend Rule 11900 (Clearance of Corporate Debt Securities) to except certain transactions in corporate debt securities.

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The Chief Legal Officer of FINRA authorized the filing of the proposed rule change with the SEC pursuant to delegated authority. No other action by FINRA is necessary for the filing of the proposed rule change.

FINRA has filed the proposed rule change for immediate effectiveness and the proposed rule change will become operative 30 days after the date of filing.

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

(a) Purpose

Rule 11900 under FINRA’s Uniform Practice Code (the “Rule”) sets forth members’ obligations with respect to the use of a registered clearing agency (a “clearing

¹ 15 U.S.C. 78s(b)(1).

agency”) to clear over-the-counter transactions in corporate debt securities.² Specifically, the Rule requires that a member or its agent that is a participant in a clearing agency must use the facilities of a clearing agency to clear eligible transactions between members in corporate debt securities executed over the counter.³ The Rule is intended to reduce or eliminate the risks and inefficiencies associated with broker-to-broker clearing in transactions in corporate debt securities, including trade fails and potential financial exposure.⁴ When FINRA (then NASD) adopted this requirement in 1995, NASD noted that there was a large percentage of corporate debt transactions cleared and settled broker-to-broker without using the facilities of a clearing agency, and that this process was error prone and time- and labor-intensive.⁵ These inefficiencies increased systemic clearance risk for members.⁶

FINRA is proposing to amend the Rule to provide an exception for over-the-counter transactions between members (the “parties”) where the same member (the “carrying member”) is clearing and settling both the purchase and the sale side of a transaction in a corporate debt security, and where such clearance and settlement occurs

² See Rule 11900, available at <https://www.finra.org/rules-guidance/rulebooks/finra-rules/11900>.

³ Section 17A of the Exchange Act and Rule 17Ab2-1 thereunder require entities to register with the Commission prior to performing the functions of a clearing agency. See 15 U.S.C. 78q-1; see also 17 CFR 240.17Ab2-1.

⁴ See Securities Exchange Act Release No. 35769 (May 25, 1995), 60 FR 28814 (June 2, 1995) (Order Approving File No. SR-NASD-95-11).

⁵ See Securities Exchange Act Release No. 35642 (April 24, 1995), 60 FR 21226 (May 1, 1995) (Notice of Filing of File No. SR-NASD-95-11) (“Original Proposal”).

⁶ See supra note 5.

through book-keeping transfers between the parties' accounts at the carrying member. Where the same carrying member is the clearing firm for both sides of the transaction, the seller's delivery and the buyer's receipt of the corporate debt security can be effected exclusively through book-keeping transfers between the parties' accounts at the carrying member, resulting in no net settlement obligation to or from a clearing agency. Further, where there is no net settlement obligation, the risks and inefficiencies that the Rule is intended to protect against (e.g., trade fails) are not present, and the use of a clearing agency to clear the transaction provides no additional benefit while nonetheless incurring costs for the carrying member.⁷ FINRA is, therefore, proposing the instant exception and believes that it is appropriate because the intended benefits of the Rule—i.e., to reduce or eliminate the risks and inefficiencies associated with broker-to-broker clearing—do not exist for transactions that do not result in a net settlement obligation on the clearing firm level.⁸ The proposed exception is limited to transactions where a carrying member clears for both the buyer and the seller in a transaction (i.e., where an obligation to deliver securities to, or receive securities from, a third party is not created with respect to the individual transaction).

⁷ The exception would apply only where the carrying firm internalizes the clearance of the transaction. Thus, the proposed exception would not apply to a transaction in which a member is clearing only the purchase or the sale side of a transaction.

⁸ While the current Rule provides FINRA with authority to exempt any transaction or class of transactions to accommodate special circumstances related to the clearance of such transactions or class of transactions, we do not believe that this authority is well suited to the proposed exception. See Rule 11900. Because FINRA is seeking to provide an exception for a broad class of transactions, FINRA believes it is appropriate to provide the proposed exception as an amendment to the Rule.

As noted in Item 2 of this filing, FINRA has filed the proposed rule change for immediate effectiveness. The proposed rule change will become operative 30 days after the date of filing.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁹ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

FINRA notes that the proposed exception would not alter counter-party clearing risks, such as financial exposure, because where a member or its agent utilizes the exception provided for under this proposal, it would serve as the central party on both the purchase and the sale side of the transaction and would clear and settle the transaction internally through book-keeping transfers. As such, no net settlement obligation would be created on the level of the clearing firm, and the risks and inefficiencies that the Rule is intended to protect against would not be present. Thus, FINRA believes the proposed rule change strikes an appropriate balance between providing relief uniformly to members where the Rule does not provide the intended benefits, while preserving the protections of the Rule for all other eligible transactions between members in corporate debt securities executed over the counter. Accordingly, FINRA believes the proposal promotes just and equitable principles of trade, and protects investors and the public interest.

⁹ 15 U.S.C. 78q-3(b)(6).

4. 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 exception would apply uniformly where the same carrying member clears and settles both the purchase and the sale side of a transaction in a corporate debt security through book-keeping transfers between the parties' accounts at the carrying member. FINRA discussed the proposed exception with its Uniform Practice Code and Fixed Income Committees, who supported the proposed amendment. FINRA also discussed the proposal with SIFMA's Clearing Firms Committee, which also supported the proposal.

Economic Impact Assessment

Regulatory Need

Under Rule 11900, each member or its agent that is a participant in a clearing agency is required to send eligible over-the-counter transactions between members in corporate debt securities to a clearing agency for clearing. For transactions where the same carrying member is clearing both the purchase and sale side of the transaction, the funds and the securities are reflected in each party's account at the carrying member. Thus, the clearing of such transactions can be done effectively through book-keeping transfers between the parties' accounts at the carrying member, without sending the transaction for central clearing. Specifically, because no net settlement obligation is created between the carrying member and the clearing agency for such transactions, clearing these transactions through a clearing agency does not provide the additional

benefits of reducing or eliminating the risks and inefficiencies that central clearing usually provides.

However, while the current rule requiring carrying members to clear these transactions through a clearing agency does not provide the benefits that the rule was designed to provide (e.g., mitigating counterparty risk), it nonetheless results in members incurring the costs associated with submitting these transactions for central clearing. Under the proposed amendment, carrying members would no longer be required to use the facilities of a clearing agency for clearing such transactions, and may choose to internalize the clearing and settlement of these transactions and avoid the fees that would be imposed by the clearing agency.

Economic Baseline

Currently, each member or its agent that is a participant in a clearing agency is required under Rule 11900 to send eligible over-the-counter transactions between members in corporate debt securities to a registered clearing agency for clearing and settlement. The National Securities Clearing Corporation (NSCC), a subsidiary of The Depository Trust & Clearing Corporation (DTCC), provides central clearing services for corporate debt securities, among other products. According to NSCC's website calculator, clearing fees consist of three parts: a tiered "clearance fee" based on the number of trades; a "value into net fee" based on the total value traded; and a "value out of net fee" based on the value that does not get netted.¹⁰

¹⁰ See NSCC Clearing Activity Monthly Fee Calculators, available at: <http://www.dtcc.com/forms/clearing-fee-calculator-new>.

Economic Impacts

When internally clearing a transaction, the delivery of the corporate debt security and money by the respective parties to settle a transaction can be effected through book-keeping transfers between the buyer's and seller's accounts at the carrying member. Under the proposed exception, carrying members would be able to avoid the clearing costs imposed by the clearing agency while continuing to clear and settle the transaction on behalf of both counterparties. Potential savings from internalizing the clearance of these transactions may or may not be passed on to the customers of the carrying member. FINRA notes that these potential cost savings are not at the expense of losing the benefits offered by clearing agencies, namely mitigating counterparty risk and increasing efficiency. This is because, when the same carrying firm is clearing for both the buy and sell side of a transaction, counterparty risk is not inherently present as no net settlement obligation to or from the carrying member is created. Therefore, by permitting members to elect to clear these transactions internally, the buyers' and sellers' counterparty risk remains unchanged.

FINRA understands that internalizing the clearance of such transactions alone would not affect the clearing agency's margin calculation for a clearing firm availing itself of the exception. Based on a conversation with DTCC, margin is collected when there is a net debit after performing mark-to-market of the trades submitted. Therefore, when clearing firms choose to internalize the clearance of transactions that create no net settlement obligations, we understand that the margin required by the clearing agency is not changed.

When a carrying firm chooses to clear transactions internally, DTCC may lose revenues from the clearing fees collected from that firm (assuming the fee structure remains unchanged). NSCC generally charges lower clearing fees for transactions that can be netted out.¹¹ Based on the 2014 NSCC calculator, the value fee (dollar per million traded) for clearing such transactions is 12.3% of the fee for clearing transactions that cannot be netted out.¹²

Competition and Efficiency

FINRA expects that the proposed amendment will improve the efficiency of the clearing process by removing a step that does not provide the intended benefit and allowing over-the-counter transactions in corporate debt securities that create no net settlement obligation to be internally cleared by the carrying firm, as described above. Carrying firms will potentially save on clearing costs for such transactions in circumstances where central clearing would not provide the additional protections related to counterparty risks or improved efficiency over bilateral clearing that were envisioned at the time Rule 11900 was adopted.

Clearing firms that serve more customers engaging in eligible over-the-counter transactions in corporate debt securities likely may benefit more from the proposed exception. The percentage of such transactions that can be internalized may in turn be higher than that of smaller clearing firms. To the extent smaller firms have eligible transactions that may be internalized under the proposal, they also should benefit from

¹¹ See supra note 10.

¹² See supra note 10.

the proposal should they choose to internalize clearing, where permitted, and avoid related central clearing costs.

Alternatives Considered

No alternatives were considered for this proposal.

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

FINRA received an email from Pershing LLC (“Pershing”) relating to the need for the proposed rule change.¹³ Pershing stated that, in submitting trades to NSCC where Pershing is clearing for both the buyer and the seller, there is no net risk mitigation because there is no net settlement obligation created. Further, Pershing stated that, by not submitting these specific transactions to NSCC, it would realize significant cost savings. As a result, Pershing requested that FINRA except from Rule 11900 the class of transactions for which a member is the clearing firm for both the buyer and the seller, to allow it to clear those transactions internally. Pershing specified that it was not requesting relief for any transaction in which a counterparty clears at an NSCC Participant other than Pershing. FINRA believes that the instant proposal provides the narrow relief that Pershing requested, and notes that the exception would be available to all members that meet the requirements of the exception. As discussed above, FINRA believes the proposed rule change strikes an appropriate balance between providing relief uniformly to members where the Rule does not provide the intended benefits, and preserving the protections of the Rule for all other eligible transactions between members in corporate debt securities executed over the counter.

¹³ See Exhibit 2.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

The proposed rule change is effective upon filing pursuant to Section 19(b)(3) of the Act¹⁴ and paragraph (f)(6) of Rule 19b-4 thereunder,¹⁵ in that the proposed rule change does not significantly affect the protection of investors or the public interest; does not impose any significant burden on competition; and does not become operative for 30 days after filing or such shorter time as the Commission may designate. In accordance with Rule 19b-4(f)(6), FINRA submitted written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing, or such shorter time as the Commission may designate, as specified in Rule 19b-4(f)(6)(iii) under the Act.

The proposed rule change provides an exception for a class of transactions where the same carrying member clears and settles both the purchase and the sale side of a over-the-counter transaction in a corporate debt security exclusively through book-keeping transfers between the parties' accounts at the carrying member. FINRA believes that the proposed rule change is consistent with the Act and strikes an appropriate balance between providing uniform relief to members where the Rule does not provide the intended benefits, and preserving the protections of the Rule for all other eligible transactions between members in corporate debt securities executed over the counter.

¹⁴ 15 U.S.C. 78s(b)(3).

¹⁵ 17 CFR 240.19b-4(f)(6).

Accordingly, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁶ and paragraph (f)(6) of Rule 19b-4 thereunder.¹⁷

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 2. Comment received relating to the proposed rule change.

Exhibit 5. Text of the proposed rule change.

¹⁶ 15 U.S.C. 78s(b)(3)(A).

¹⁷ 17 CFR 240.19b-4(f)(6).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2020-002)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend FINRA Rule 11900 to Except Certain Transactions in Corporate Debt Securities

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 , 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. FINRA has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,³ which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend Rule 11900 (Clearance of Corporate Debt Securities) to except certain transactions in corporate debt securities.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

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 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

Rule 11900 under FINRA's Uniform Practice Code (the "Rule") sets forth members' obligations with respect to the use of a registered clearing agency (a "clearing agency") to clear over-the-counter transactions in corporate debt securities.⁴ Specifically, the Rule requires that a member or its agent that is a participant in a clearing agency must use the facilities of a clearing agency to clear eligible transactions between members in corporate debt securities executed over the counter.⁵ The Rule is intended to reduce or eliminate the risks and inefficiencies associated with broker-to-broker clearing in

⁴ See Rule 11900, available at <https://www.finra.org/rules-guidance/rulebooks/finra-rules/11900>.

⁵ Section 17A of the Exchange Act and Rule 17Ab2-1 thereunder require entities to register with the Commission prior to performing the functions of a clearing agency. See 15 U.S.C. 78q-1; see also 17 CFR 240.17Ab2-1.

transactions in corporate debt securities, including trade fails and potential financial exposure.⁶ When FINRA (then NASD) adopted this requirement in 1995, NASD noted that there was a large percentage of corporate debt transactions cleared and settled broker-to-broker without using the facilities of a clearing agency, and that this process was error prone and time- and labor-intensive.⁷ These inefficiencies increased systemic clearance risk for members.⁸

FINRA is proposing to amend the Rule to provide an exception for over-the-counter transactions between members (the “parties”) where the same member (the “carrying member”) is clearing and settling both the purchase and the sale side of a transaction in a corporate debt security, and where such clearance and settlement occurs through book-keeping transfers between the parties’ accounts at the carrying member. Where the same carrying member is the clearing firm for both sides of the transaction, the seller’s delivery and the buyer’s receipt of the corporate debt security can be effected exclusively through book-keeping transfers between the parties’ accounts at the carrying member, resulting in no net settlement obligation to or from a clearing agency. Further, where there is no net settlement obligation, the risks and inefficiencies that the Rule is intended to protect against (e.g., trade fails) are not present, and the use of a clearing agency to clear the transaction provides no additional benefit while nonetheless incurring

⁶ See Securities Exchange Act Release No. 35769 (May 25, 1995), 60 FR 28814 (June 2, 1995) (Order Approving File No. SR-NASD-95-11).

⁷ See Securities Exchange Act Release No. 35642 (April 24, 1995), 60 FR 21226 (May 1, 1995) (Notice of Filing of File No. SR-NASD-95-11) (“Original Proposal”).

⁸ See supra note 7.

costs for the carrying member.⁹ FINRA is, therefore, proposing the instant exception and believes that it is appropriate because the intended benefits of the Rule—i.e., to reduce or eliminate the risks and inefficiencies associated with broker-to-broker clearing—do not exist for transactions that do not result in a net settlement obligation on the clearing firm level.¹⁰ The proposed exception is limited to transactions where a carrying member clears for both the buyer and the seller in a transaction (i.e., where an obligation to deliver securities to, or receive securities from, a third party is not created with respect to the individual transaction).

FINRA has filed the proposed rule change for immediate effectiveness. The proposed rule change will become operative 30 days after the date of filing.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹¹ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote

⁹ The exception would apply only where the carrying firm internalizes the clearance of the transaction. Thus, the proposed exception would not apply to a transaction in which a member is clearing only the purchase or the sale side of a transaction.

¹⁰ While the current Rule provides FINRA with authority to exempt any transaction or class of transactions to accommodate special circumstances related to the clearance of such transactions or class of transactions, we do not believe that this authority is well suited to the proposed exception. See Rule 11900. Because FINRA is seeking to provide an exception for a broad class of transactions, FINRA believes it is appropriate to provide the proposed exception as an amendment to the Rule.

¹¹ 15 U.S.C. 78q-3(b)(6).

just and equitable principles of trade, and, in general, to protect investors and the public interest.

FINRA notes that the proposed exception would not alter counter-party clearing risks, such as financial exposure, because where a member or its agent utilizes the exception provided for under this proposal, it would serve as the central party on both the purchase and the sale side of the transaction and would clear and settle the transaction internally through book-keeping transfers. As such, no net settlement obligation would be created on the level of the clearing firm, and the risks and inefficiencies that the Rule is intended to protect against would not be present. Thus, FINRA believes the proposed rule change strikes an appropriate balance between providing relief uniformly to members where the Rule does not provide the intended benefits, while preserving the protections of the Rule for all other eligible transactions between members in corporate debt securities executed over the counter. Accordingly, FINRA believes the proposal promotes just and equitable principles of trade, and protects investors and the public interest.

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 exception would apply uniformly where the same carrying member clears and settles both the purchase and the sale side of a transaction in a corporate debt security through book-keeping transfers between the parties' accounts at the carrying member. FINRA discussed the proposed exception with its Uniform Practice Code and Fixed Income Committees, who supported the proposed amendment. FINRA also

discussed the proposal with SIFMA's Clearing Firms Committee, which also supported the proposal.

Economic Impact Assessment

Regulatory Need

Under Rule 11900, each member or its agent that is a participant in a clearing agency is required to send eligible over-the-counter transactions between members in corporate debt securities to a clearing agency for clearing. For transactions where the same carrying member is clearing both the purchase and sale side of the transaction, the funds and the securities are reflected in each party's account at the carrying member. Thus, the clearing of such transactions can be done effectively through book-keeping transfers between the parties' accounts at the carrying member, without sending the transaction for central clearing. Specifically, because no net settlement obligation is created between the carrying member and the clearing agency for such transactions, clearing these transactions through a clearing agency does not provide the additional benefits of reducing or eliminating the risks and inefficiencies that central clearing usually provides.

However, while the current rule requiring carrying members to clear these transactions through a clearing agency does not provide the benefits that the rule was designed to provide (e.g., mitigating counterparty risk), it nonetheless results in members incurring the costs associated with submitting these transactions for central clearing. Under the proposed amendment, carrying members would no longer be required to use the facilities of a clearing agency for clearing such transactions, and may choose to

internalize the clearing and settlement of these transactions and avoid the fees that would be imposed by the clearing agency.

Economic Baseline

Currently, each member or its agent that is a participant in a clearing agency is required under Rule 11900 to send eligible over-the-counter transactions between members in corporate debt securities to a registered clearing agency for clearing and settlement. The National Securities Clearing Corporation (NSCC), a subsidiary of The Depository Trust & Clearing Corporation (DTCC), provides central clearing services for corporate debt securities, among other products. According to NSCC's website calculator, clearing fees consist of three parts: a tiered "clearance fee" based on the number of trades; a "value into net fee" based on the total value traded; and a "value out of net fee" based on the value that does not get netted.¹²

Economic Impacts

When internally clearing a transaction, the delivery of the corporate debt security and money by the respective parties to settle a transaction can be effected through book-keeping transfers between the buyer's and seller's accounts at the carrying member. Under the proposed exception, carrying members would be able to avoid the clearing costs imposed by the clearing agency while continuing to clear and settle the transaction on behalf of both counterparties. Potential savings from internalizing the clearance of these transactions may or may not be passed on to the customers of the carrying member. FINRA notes that these potential cost savings are not at the expense of losing the benefits

¹² See NSCC Clearing Activity Monthly Fee Calculators, available at: <http://www.dtcc.com/forms/clearing-fee-calculator-new>.

offered by clearing agencies, namely mitigating counterparty risk and increasing efficiency. This is because, when the same carrying firm is clearing for both the buy and sell side of a transaction, counterparty risk is not inherently present as no net settlement obligation to or from the carrying member is created. Therefore, by permitting members to elect to clear these transactions internally, the buyers' and sellers' counterparty risk remains unchanged.

FINRA understands that internalizing the clearance of such transactions alone would not affect the clearing agency's margin calculation for a clearing firm availing itself of the exception. Based on a conversation with DTCC, margin is collected when there is a net debit after performing mark-to-market of the trades submitted. Therefore, when clearing firms choose to internalize the clearance of transactions that create no net settlement obligations, we understand that the margin required by the clearing agency is not changed.

When a carrying firm chooses to clear transactions internally, DTCC may lose revenues from the clearing fees collected from that firm (assuming the fee structure remains unchanged). NSCC generally charges lower clearing fees for transactions that can be netted out.¹³ Based on the 2014 NSCC calculator, the value fee (dollar per million traded) for clearing such transactions is 12.3% of the fee for clearing transactions that cannot be netted out.¹⁴

¹³ See supra note 12.

¹⁴ See supra note 12.

Competition and Efficiency

FINRA expects that the proposed amendment will improve the efficiency of the clearing process by removing a step that does not provide the intended benefit and allowing over-the-counter transactions in corporate debt securities that create no net settlement obligation to be internally cleared by the carrying firm, as described above. Carrying firms will potentially save on clearing costs for such transactions in circumstances where central clearing would not provide the additional protections related to counterparty risks or improved efficiency over bilateral clearing that were envisioned at the time Rule 11900 was adopted.

Clearing firms that serve more customers engaging in eligible over-the-counter transactions in corporate debt securities likely may benefit more from the proposed exception. The percentage of such transactions that can be internalized may in turn be higher than that of smaller clearing firms. To the extent smaller firms have eligible transactions that may be internalized under the proposal, they also should benefit from the proposal should they choose to internalize clearing, where permitted, and avoid related central clearing costs.

Alternatives Considered

No alternatives were considered for this proposal.

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

FINRA received an email from Pershing LLC ("Pershing") relating to the need for the proposed rule change.¹⁵ Pershing stated that, in submitting trades to NSCC where

¹⁵ See Exhibit 2.

Pershing is clearing for both the buyer and the seller, there is no net risk mitigation because there is no net settlement obligation created. Further, Pershing stated that, by not submitting these specific transactions to NSCC, it would realize significant cost savings. As a result, Pershing requested that FINRA except from Rule 11900 the class of transactions for which a member is the clearing firm for both the buyer and the seller, to allow it to clear those transactions internally. Pershing specified that it was not requesting relief for any transaction in which a counterparty clears at an NSCC Participant other than Pershing. FINRA believes that the instant proposal provides the narrow relief that Pershing requested, and notes that the exception would be available to all members that meet the requirements of the exception. As discussed above, FINRA believes the proposed rule change strikes an appropriate balance between providing relief uniformly to members where the Rule does not provide the intended benefits, and preserving the protections of the Rule for all other eligible transactions between members in corporate debt securities executed over the counter.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁶ and Rule 19b-4(f)(6) thereunder.¹⁷

¹⁶ 15 U.S.C. 78s(b)(3)(A).

¹⁷ 17 CFR 240.19b-4(f)(6).

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or 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-2020-002 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-2020-002. 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-2020-002 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

Jill M. Peterson
Assistant Secretary

¹⁸ 17 CFR 200.30-3(a)(12).

From: [Lawrence, Jesse](#)
To: [Stanton, Brian](#)
Cc: [Queripel, Paul](#); [Cocorikis, Todd](#); [Klubeck, Irving](#); [Santaniello, Claire H](#); [Brereton, Joseph](#)
Subject: Request for Relief from FINRA Rule 11900

Brian,

As we have discussed, Pershing is formally requesting relief, pursuant to FINRA Rule 9600, to exempt a class of corporate debt transactions from FINRA Rule 11900 which requires a member firm to use the facilities of a registered clearing agency for the clearance of eligible transactions between members in corporate debt securities.

FINRA Rule 11900 states:

Each member or its agent that is a participant in a registered clearing agency, for purposes of clearing over-the-counter securities transactions, shall use the facilities of a registered clearing agency for the clearance of eligible transactions between members in corporate debt securities. Pursuant to the [Rule 9600 \[finra.complinet.com\]](#) Series, FINRA may exempt any transaction or class of transactions in corporate debt securities from the provision of this Rule as may be necessary to accommodate special circumstances related to the clearance of such transactions or class of transactions.

As we have discussed, Pershing, as clearing broker, currently submits corporate debt transactions to NSCC that it is clearing on behalf of introducing-broker dealers that have traded with one another. In those cases where we are clearing for both the buyer and seller, Pershing is submitting on behalf of both the buyer and seller under our NSCC Number, 0443. In submitting both sides to NSCC, there is no net risk mitigation through the utility as there is no net settlement obligation created.

For example, IBD A sells 1000 Corporate Bonds to IBD B. In the current state, Pershing submits both the purchase and sale to NSCC. The net effect will be a delivery obligation of 1000 Corporate Bonds to NSCC on behalf of the seller, IBD A, which will offset by the expected receipt of 1000 Corporate Bonds from NSCC for the benefit of IBD B. The result is there will be no net settlement obligation to or from NSCC.

Pershing is requesting relief for the class of transactions for which it is the clearing firm for both the buyer and seller only. These transactions will be cleared internally at Pershing and will not be submitted to NSCC. For the avoidance of doubt, Pershing is not requesting relief for any transaction in which a counterparty clears at an NSCC Participant other than Pershing.

We would like to reinforce that this request for relief will not expose Pershing or any other member firm to any additional risk. Pershing has confirmed with NSCC that there is no requirement under NSCC rules to submit these transactions to NSCC. Finally, by not submitting these specific transactions for which Pershing is clearing for both the buyer and the seller, Pershing will realize significant cost savings.

Thank you for your consideration. Please do not hesitate to reach out if you have any questions or require further information.

Jesse Lawrence
Managing Director
Associate General Counsel
Pershing LLC/Lockwood Advisors, Inc.
Phone: (201) 413-2499
Email: jelawrence@pershing.com

EXHIBIT 5

Below is the text of the proposed rule change. Proposed new language is underlined.

* * * * *

11000. UNIFORM PRACTICE CODE

* * * * *

11900. Clearance of Corporate Debt Securities

(a) Each member or its agent that is a participant in a registered clearing agency, for purposes of clearing over-the-counter securities transactions, shall use the facilities of a registered clearing agency for the clearance of eligible transactions between members in corporate debt securities.

(b) Paragraph (a) of this Rule does not apply to a transaction between members (the “parties”) whose accounts are carried by a member (the “carrying member”) that clears and settles the transaction through book-keeping transfers between the parties’ accounts at the carrying member.

(c) Pursuant to the Rule 9600 Series, FINRA may exempt any transaction or class of transactions in corporate debt securities from the provision of this Rule as may be necessary to accommodate special circumstances related to the clearance of such transactions or class of transactions.

* * * * *