CITADEL | Securities

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Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 2006–1506

Re: FINRA Review to Modernize Rules Regarding Member Firms and Associated Persons (Regulatory Notice 25-04)

Citadel Securities strongly supports FINRA's initiative to review and modernize its rules in light of market structure evolution.[1] Technology, innovation, and competition continue to reshape U.S. financial markets, and now is the right time to comprehensively review the current regulatory framework and take decisive action to remove unnecessary costs and increase efficiency to unleash a new wave of innovation and investment. Our capital markets are the envy of the world, and we must continue to foster and embrace competition, innovation, and smart regulation.

Below, we provide specific recommendations relating to current FINRA rules that are designed to improve efficiency and competition, and reduce unnecessary regulatory burdens.

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[1] https://www.finra.org/rules-guidance/notices/25-04.

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I. Modernizing Key FINRA Rules

A. Improving the "Riskless Principal" Definition

FINRA trade reporting rules define a "riskless principal" transaction as a transaction in which a member, after having received an order to buy (sell) a security, purchases (sells) the security as principal and satisfies the original order by selling (buying) as principal *at the same price (excluding any mark-up, mark-down, commission-equivalent, or other fee)*.[2]

This definition could be interpreted to exclude instances where a member acts as riskless principal for a customer order, but gives the customer a better price than the price the member obtains on the market-facing leg (i.e. price improvement). Such an interpretation leads to inaccurate data regarding market trading activity and order routing, and could unnecessarily limit price improvement opportunities for customers. As such, FINRA should clarify that the current riskless principal definition accommodates customer price improvement by affirming that the relevant "mark-up" or "mark-down" on a given transaction could be negative (i.e. in the customer's favor). Alternatively, FINRA could remove the reference to "at the same price."

We note that FINRA should also identify other instances where a "riskless principal" definition appears in its ruleset and make appropriate conforming changes.

B. Updating the Manning Rule Following Recent SEC Rule Changes

FINRA Rule 5320 prohibits member firms from trading ahead of customer orders. The Supplementary Material contains, among others, a limited exception that sets forth the minimum amount of price improvement necessary for a member to execute an order on a proprietary basis when holding an unexecuted limit order in that same security without being required to execute the held limit order.[3] This minimum amount of price improvement is currently set at one penny for NMS stocks and customer limit orders priced greater than or equal to $1.00, reflecting the minimum quoting increment currently set forth in Rule 612 of Regulation NMS.[4]

On September 18, 2024, the SEC amended Rule 612 by reducing the minimum quoting increment to $0.005 for certain NMS stocks.[5] However, the rule is now being challenged in court and the SEC has stayed its effective date.[6] To the extent this SEC rule change moves forward, FINRA must maintain consistency by making conforming changes to Supplementary Material .06 to reflect the smaller quoting minimum increments in certain symbols.

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[2] FINRA Rule 6380B.

[3] Rule 5320 Supplementary Material .06.

[4] Notice of Proposed Rule Change to Amend the Minimum Price-Improvement Standards Set Forth in NASD IM 2110-02, Trading Ahed of Customer Limit Orders, 72 Fed. Reg. 49337 (Aug. 28, 2007) available at: https://www.govinfo.gov/content/pkg/FR-2007-08-28/pdf/E7-16955.pdf.

[5] Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, 89 Fed. Reg. 81620 (Oct. 8, 2024), available at: https://www.govinfo.gov/content/pkg/FR-2024-10-08/pdf/2024-21867.pdf.

[6] Exch. Act Rel. No. 101899 (Dec. 12, 2024), available at: https://www.sec.gov/files/rules/other/2024/34-101899.pdf.

C. Removing Conflicts of Interest in Corporate Bond Offerings[7]

FINRA Rule 5131 seeks to mitigate conflicts of interest in the new issuance allocation process by prohibiting underwriters from inappropriately tying or bundling other services (such as secondary market trading) to investor allocation decisions. Specifically, FINRA rules prohibit underwriters from allocating shares of a new issuance "as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member." [8] Nonetheless, academic research suggests that the amount of secondary market trading activity directed by an investor to a specific underwriter can be an important factor in new issuance allocation decisions.[9]

We thus recommend that FINRA enhance Rule 5131 to specifically prohibit tying or bundling secondary market trading to investor allocation decisions. Tying or bundling secondary market trading activity to new issuance allocations negatively impacts the U.S. corporate bond market, as secondary trading activity is artificially concentrated among a small group of underwriters, thus decreasing market competition and liquidity, and increasing transaction costs for all investors.

II. Coordinating With the SEC to Modernize Overlapping Rulesets

A. Tackling the Growth of Private Rooms on ATSs

As detailed in our recent White Paper "*Enhancing Competition and Innovation in U.S. Financial Markets*,"[10] so-called "private rooms – where a single firm can elect to interact with order flow from one or more chosen counterparties to the exclusion of everyone else – are increasingly common on ATSs. Private rooms raise a number of novel concerns that warrant regulatory scrutiny, including the level of compliance with (i) the definition of an ATS, (ii) ATS transparency requirements, (iii) execution quality disclosure requirements, (iv) best execution requirements, and (v) monitoring and surveillance responsibilities.

FINRA has a role in evaluating compliance with many of these regulatory requirements given its oversight over the broker-dealer operator of an ATS. We, therefore, recommend that FINRA work closely with the SEC to determine whether ATS are offering "private rooms" in a compliant manner (for example, it appears that ATSs are circumventing execution quality disclosure requirements by automatically deeming all orders to be "not held" – even retail orders executed in

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[7] We note this recommendation is also relevant for the related consultation on modernizing FINRA rules to facilitate capital formation (Regulatory Notice 25-06).

[8] FINRA Rule 5131.

[9] S. Nikolova, et. al., "Institutional Allocations in the Primary Market for Corporate Bonds," Journal of Financial Economics (2020) available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3181983 ("Even more importantly, insurers with a stronger trading relationship with an offering's underwriters, measured as the percent of the lead underwriters' prior-year trading volume that comes from the insurers, receive more profitable allocations.").

[10] https://www.citadelsecurities.com/wp-content/uploads/sites/2/2025/04/Citadel-Securities-White-Paper-Enhancing-Competition-and-Innovation-in-US-Financial-Markets-April-2025.pdf.

"private rooms" – in order to avoid preparing a Rule 605 execution quality report[11]) and propose regulatory clarifications and enhancements where appropriate in response. A retail order should benefit from equivalent levels of execution quality transparency, regardless of where it is executed, and FINRA (in conjunction with the SEC) should ensure all ATSs publish Rule 605 reports.

B. Improving the Margin Framework for Listed Options

Margin requirements for customers in the listed options market are set by reference to SEC, FINRA, and OCC rules.[12] Experience has demonstrated that the current margin framework is insufficiently risk-based. For example, per contract minimum margin levels often appear to dictate overall margin requirements, even though they are completely divorced from the market risk associated with a particular cleared portfolio. In addition, the OCC's TIMS methodology for customers can yield very different results than its separate STANS methodology that is applied to direct OCC members. Finally, cross-margining between options positions cleared at the OCC and equities positions cleared at the NSCC is currently not supported, which also unnecessarily increases costs for market participants.

We recommend that FINRA work with the OCC and the SEC to improve the customer margin framework for listed options by making it more risk-based and increasing alignment with the STANS methodology used for direct OCC members. In addition, FINRA should support industry efforts to introduce cross-margining between listed options and equities.

C. Critically Evaluating Intentional Delay Mechanisms

In the equities market, top-of-book displayed and accessible quotations on each exchange are considered to be "protected," meaning that market participants must route order flow to execute against those prices before accessing deeper liquidity. In order for a quotation to be "protected," Rule 600 of Regulation NMS provides that it must be "immediately and automatically" accessible.[13] When adopting Regulation NMS, the Commission clarified that "[t]he term 'immediate' precludes any coding of automated systems or other type of intentional device that would delay the action taken with respect to a quotation."[14] However, in 2016, the Commission opted to unilaterally reinterpret the term "immediate" to allow for "de minimis" intentional delays.[15]

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[11] *See, e.g.,* IntelligentCross ATS-N Part III, Item 7 ("All orders entered into the ATS by Subscribers are Not Held"), available at: https://www.sec.gov/Archives/edgar/data/1708826/000170882625000002/xslATS-N_X01/primary_doc.xml.

[12] *See* SEC Rule 15c3-1, FINRA Rule 4210, and the OCC TIMS Methodology.

[13] 17 CFR 242.600(b)(3).

[14] *See* Securities Exchange Act Release No. 51808 (June 9, 2005).

[15] Interpretation Regarding Automated Quotations Under Regulation NMS, 81 FR 40785 (June 23, 2016), available at: https://www.govinfo.gov/content/pkg/FR-2016-06-23/pdf/2016-14876.pdf. In doing so, the SEC rejected a "bright line" threshold of "one millisecond" for determining whether an intentional delay is *de minimis*, and instead set a standard: a *de minimis* intentional delay must be one "so short as to not frustrate the purposes of Rule 611 by impairing fair and efficient access to an exchange's quotations."

Since then, several trading venues have attempted to push the boundaries of what constitutes a "protected" quotation, proposing various intentional delays – combined with functionality that enables displayed quotations to be cancelled during the intentional delay – that have the effect of advantaging a select group of market makers. Asymmetric intentional delays are particularly nefarious, as they provide certain market participants with a "last look" option to cancel resting orders before execution, impairing efficient access to displayed quotes and reducing fill rates and increasing transaction costs for investors. Even worse, these proposals typically seek to compel all investors to chase the resulting inaccessible quotes due to the "order protection rule."

As the SEC has evaluated these proposals, it is clear that there is not a well-defined framework for determining what constitutes a "de minimis" intentional delay and the degree to which protected quotes can be made "conditional," leading to arbitrary decision making. The latest filing under consideration involves a FINRA-endorsed proposal to grant "protected" quote status to an ATS for the first time, even though it includes a deeply problematic intentional delay specifically designed to benefit the ATS's select cadre of market makers.[16] Intentional delays are also being newly proposed for the listed options market.

In light of these market developments, we recommend that FINRA work with the SEC to provide greater clarity and consistency in this area. This includes reverting to the "protected" quote definition set forth in Regulation NMS in 2005, and ensuring that any revisions to that definition are effected through the standard rulemaking process. While trading venue innovation should be applauded, to the extent that market participants are affirmatively compelled to access certain venues due to regulatory fiat – e.g. "protected" quote status – it is critical that consistent standards be applied and that investors are not required to chase inaccessible quotes.

III. <u>Enhancing Public Reporting Regimes Administered by FINRA</u>

A. Aligning the TRF and SIP Hours of Operation

Several exchanges have recently filed to support overnight trading of equities. SEC approval has been conditioned on the SIPs being able to "collect, consolidate, process and disseminate consolidated data" during the overnight session.[17] However, the expansion of overnight trading should also be conditioned on FINRA extending the TRF hours of operation in an equivalent manner.[18] It is anticipated that off-exchange venues will be a significant source of liquidity during the overnight session, and a failure to provide real-time transparency in this segment of the market will complicate compliance with key regulatory requirements, such as best execution, and could lead to information asymmetries that exacerbate market volatility.

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[16] *See, e.g.,* Citadel Securities Statement in Opposition (Oct. 29, 2023), available at: https://www.sec.gov/comments/sr-finra-2022-032/srfinra2022032-286679-699882.pdf. The associated comment file demonstrates widespread opposition to this proposal.

[17] In the Matter of the Application of 24X National Exchange LLC for Registration as a National Securities Exchanges, 89 Fed. Reg. 97092 (Dec. 6, 2024) at 97111, available at: https://www.govinfo.gov/content/pkg/FR-2024-12-06/pdf/2024-28551.pdf.

[18] *See* https://www.prnewswire.com/news-releases/sips-to-propose-extended-operating-hours-302447700.html.

B. Enhancing TRACE Reporting – Corporate Bonds

The TRACE reporting framework for corporate bonds has become a gold standard globally across asset classes, with academic research overwhelmingly confirming the benefits for investors and the overall market. However, additional steps can be taken to further enhance the quality of information publicly disclosed to investors.

First, FINRA should amend its rules to allow members to identify to FINRA riskless principal transactions involving affiliated member firms, which will enable FINRA to suppress the public dissemination of the inter-affiliate leg of these trades. The public reporting of both legs of these riskless principal transactions results in duplicative information that is not useful to investors for pricing, valuation or risk purposes. FINRA rules already allow members to identify and suppress the public dissemination of riskless principal transactions involving non-member affiliates, and this practice should be extended to riskless principal transactions involving affiliates that *are* FINRA members.

Second, we recommend that FINRA work with the SEC to improve the transparency of block trades. Under current rules, TRACE does not immediately disclose the notional size of corporate bond transactions that exceed the block trade threshold, which is $5 million for investment grade bonds and $1 million for high yield bonds. Data shows that more than 50% of notional traded in investment grade bonds and as much as 85% of notional traded in high yield bonds now qualifies as a block trade.[19] The actual notional size of these transactions is then publicly disclosed on a quarterly basis no earlier than 6 months after the transaction date.[20] FINRA should reduce the timeline for publishing full notional sizes, as the current 6 month timeline hampers best execution analyses by investors and creates an unlevel playing field with respect to access to information. FINRA should also raise the block trade thresholds to better reflect current market dynamics, as they have not been updated since TRACE was first implemented in the early 2000s. In other asset classes, regulators have sought to ensure that no more than 33% of total notional traded in a particular instrument is eligible for block trade treatment.[21] This approach is designed to provide market participants with a timely view of a large-enough portion of transaction and pricing data to conduct meaningful best execution analysis, while still permitting truly large transactions to qualify for block trade status.

C. Enhancing TRACE Reporting – U.S. Treasuries

The U.S. Treasury market remains an outlier with respect to post-trade transparency in that it has only recently implemented end-of-day public dissemination for transactions in the limited set of on-the-run securities.[22] In the dealer-to-customer segment of the market for nominal coupons,

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[19] *See, e.g.,* Fixed Income Market Structure Advisory Committee, April 9, 2018, available at: https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-block-trade-recommendation.pdf.

[20] https://www.finra.org/filing-reporting/trace/historic-academic-data.

[21] *See* Procedures To Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 FR 15460 (May 31, 2013), available at: https://www.govinfo.gov/content/pkg/FR-2013-05-31/pdf/2013-12133.pdf.

[22] 88 FR 77388 (Nov. 9, 2023).

where investors would benefit from far greater transparency, more than 50% of all transactions and more than 30% of total notional traded are in off-the-run Treasuries, which are completely excluded from current public dissemination requirements for individual transactions.[23] We urge FINRA to work with other policymakers to improve U.S. Treasury market functioning by more closely replicating the post-trade transparency framework for corporate bonds. This includes (i) significantly reducing the current end-of-day public dissemination timeframe for transactions in on-the-run securities and (ii) expanding reporting requirements to off-the-run Treasury securities.

D. Introducing Post-Trade Transparency for OTC Options

FINRA's expertise in administering public reporting regimes across asset classes makes it well-suited to work with the SEC to implement post-trade transparency for over-the-counter options. Currently, the OTC options market is opaque, and market participants (not only in OTC options but also in correlated markets) would meaningfully benefit from the introduction of timely public reporting of transaction-level data (including price, size, and execution time).

IV. Increasing Regulatory Efficiency

A. Rationalizing Market Surveillance in Equities and Options

(i) *The Consolidated Audit Trail*

As detailed in our recent White Paper "*Enhancing Competition and Innovation in U.S. Financial Markets*," the Consolidated Audit Trail ("CAT") is not operating on firm footing, plagued by wasteful spending, ineffective governance, and a plethora of data privacy and cybersecurity concerns. We urge FINRA to work with the SEC and the other SROs to improve the operation and oversight of the CAT while maintaining robust market surveillance. Key objectives include (a) dramatically reducing the operational costs of the CAT and (b) requiring the operational costs of the CAT to be included in the SEC's budget in order to ensure appropriate oversight and alignment of incentives.

(ii) *Electronic Blue Sheets*

When the SEC directed the SROs to submit a plan to create the CAT, the SEC expressly contemplated that the CAT would result in the retirement of the parallel electronic blue sheets system ("EBS").[24] Yet even though the CAT is now fully operational, the EBS system has not been retired. This results in market participants incurring duplicative costs for market surveillance and FINRA should work with the SEC to rectify this situation.

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[23] *See* https://www.finra.org/finra-data/browse-catalog/about-treasury/monthly-file.

[24] Consolidated Audit Trail, 77 Fed. Reg. 45722 (Aug. 1, 2012).

(iii) *Options Regulatory Fee*

In the listed options market, each exchange assesses its own "options regulatory fee" on market participants. We encourage FINRA to work with the options exchanges to explore how to better streamline cross-market surveillance and reduce associated costs given FINRA's expertise in this area.

B. Improving the Fairness of the Trading Activity Fee

FINRA assesses a trading activity fee ("TAF") to help recover the costs of supervising member firms. At the moment, the TAF is assessed against transactions in equities, options, security futures, and bonds.[25] We recommend that FINRA consider expanding this list to include other asset classes covered by FINRA rules, including security-based swaps and digital assets that are securities.

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We thank FINRA for considering our comments.

Please feel free to call the undersigned with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director

Global Head of Government & Regulatory Policy

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[25] FINRA By-Laws Section 1, Appendix A, available at https://www.finra.org/rules-guidance/rulebooks/corporate-organization/section-1-member-regulatory-fees.