

Regulatory Notice

09-08

Trade Reporting

SEC Approves Amendments to FINRA Trade Reporting Rules

Effective Date: August 3, 2009

Executive Summary

Effective Monday, August 3, 2009, firms' trade reporting obligations for over-the-counter (OTC) equity transactions¹ will change. Specifically, amendments to FINRA trade reporting rules will:

- replace the current market maker-based trade reporting structure with an "executing party" structure; and
- require firms with the trade reporting obligation that are acting in a riskless principal or agency capacity on behalf of another member firm(s) to submit non-tape report(s) to FINRA, as necessary, to identify such other firm(s) as a party to the trade.

The text of the amendments can be found at www.finra.org/rulefilings/2008-011/.

Questions regarding this *Notice* may be directed to the Legal Section, Market Regulation, at (240) 386-5126; or the Office of General Counsel, at (202) 728-8071.

January 2009

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Executive Representatives
- Legal
- Operations
- Senior Management
- Systems
- Trading
- Training

Key Topic(s)

- Alternative Display Facility
- Agency Transactions
- Direct Participation Program Securities
- NMS Stocks
- OTC Equity Securities
- OTC Reporting Facility
- PORTAL Equity Securities
- Riskless Principal Transactions
- Trade Reporting
- Trade Reporting Facilities

Referenced Rules & Notices

- FINRA Rule 6282
- FINRA Rule 6380A
- FINRA Rule 6380B
- FINRA Rule 6420
- FINRA Rule 6622
- FINRA Rule 6633
- FINRA Rule 6643
- FINRA Rule 7230A
- FINRA Rule 7230B
- FINRA Rule 7330



Financial Industry Regulatory Authority

Background and Discussion

Trade Reporting Structure

On November 5, 2008,² the SEC approved amendments to FINRA rules that replace the current market maker-based structure³ with a simpler, more uniform structure for purposes of reporting OTC equity transactions to FINRA. Specifically, for transactions between member firms, the “executing party” must report the trade to FINRA, and for transactions between a member firm and a non-member firm or customer, the member firm must report the trade. The “executing party” reporting structure applies to reporting trades to FINRA in NMS stocks, OTC Equity Securities, DPP securities and PORTAL equity securities.⁴

The amendments define “executing party” as the member firm that receives an order for handling or execution or is presented an order against its quote, does not subsequently re-route the order, and executes the transaction. Thus, for example, an alternative trading system (ATS) (a term that includes electronic communications networks (ECNs)) is the executing party and has the reporting obligation where the transaction is executed on the ATS. Alternatively, if an ATS routes an order to another member firm for handling and/or execution, then the ATS would not be the executing party and would not have the reporting obligation.⁵ For trades between a member firm and a non-member firm, the member firm must report the trade.

In certain limited circumstances, it may not be clear which firm should be deemed the executing party for trade reporting purposes (*e.g.*, manually negotiated trades between two members via the telephone). Accordingly, for transactions between two member firms where both firms could reasonably maintain that they satisfy the definition of “executing party,” the firm representing the sell-side must report the transaction to FINRA, unless the parties agree otherwise and the firm representing the sell-side contemporaneously documents such agreement. In such instances, the sell-side will be presumed to have the trade reporting obligation, unless it can demonstrate there was an agreement to the contrary (*e.g.*, contemporaneous notes of a telephone conversation or notation on the order ticket).

For example, if Firm A represents the sell-side and Firm B represents the buy-side in a manually negotiated trade where both member firms reasonably maintain that they satisfy the definition of “executing party,” Firm A, as the sell-side, has the reporting obligation. If the parties agree that Firm B will report the trade and Firm A contemporaneously documents the parties’ agreement, the trade reporting obligation shifts to Firm B, and Firm B is responsible for reporting the transaction in accordance with FINRA rules.

FINRA notes that the parties may comply with the “contemporaneously documented agreement” requirement through the use of a blanket agreement that expressly shifts the trade reporting obligation in this scenario (*i.e.*, in a manually negotiated trade between Firm A and Firm B, where Firm A as the sell-side has the reporting obligation, the parties agree that Firm B will have the reporting obligation).⁶

Submission of Non-Tape Reports to Identify Other Member Firms for Agency and Riskless Principal Transactions

The amendments also require that any firm with the obligation to report the trade under FINRA rules that is acting in a riskless principal⁷ or agency capacity on behalf of one or more other member firms submit to FINRA one or more non-tape report(s),⁸ as necessary, to identify such other member firm(s) as a party to the transaction.⁹ A firm that matches, as agent, the orders of multiple member firms on one or both sides of the trade may have to submit multiple non-tape reports to identify all other member firms.

It is important to note that under current FINRA rules, member firms already are required to submit a non-tape report to reflect the offsetting, “riskless” leg of a riskless principal transaction where the tape report was not properly marked as riskless principal.¹⁰ This requirement applies to all firms—even firms that do not have the responsibility to report the trade for publication purposes—and the amendments do not in any way negate or modify the existing requirements for reporting riskless principal transactions under FINRA rules. However, a firm acting on a riskless principal basis on behalf of another member firm would have no separate reporting obligation under the amendments if the other member firm is identified on the non-tape report submitted to comply with the riskless principal reporting requirements.

A firm can satisfy its reporting obligation under the amendments by submitting a clearing-only report(s), if necessary to clear the offsetting leg(s) of the transaction through a FINRA Facility. If the parties do not need to clear the offsetting leg(s) of the transaction through a FINRA Facility, then the firm must submit a non-tape, non-clearing report(s).

The non-tape reporting requirement applies only to the firm that has the responsibility under FINRA rules to report the trade to FINRA for tape purposes (*e.g.*, the “executing party” in a trade between two member firms, as discussed above). A firm that is acting on behalf of another member firm would have no separate reporting obligation under the amendments if the other member firm is identified on the initial (tape) trade report. In addition, the non-tape reporting requirement does not apply where a firm is acting as agent or riskless principal on behalf of a non-member firm. Nor does the requirement apply to transactions that are executed on and reported through an exchange; in that instance, firms have the option, as they do today, of submitting a non-tape (typically, a clearing-only) report to FINRA for the offsetting leg of the transaction.¹¹

The scope and application of the non-tape reporting requirement can be illustrated in the following examples, and FINRA also included several examples in the amended rule text. The examples are not intended to represent all possible trade reporting scenarios under the amendments. In the examples below, assume all firms are FINRA member firms (except where specifically indicated in Examples #6 and #7).

Example #1: Firm A receives a buy order from Firm B and a sell order from Firm C. Firm A matches, as agent, the orders of Firm B and Firm C. For purposes of this example, Firm A has the obligation under FINRA rules to report the trade. Under the amendments, Firm A must submit a non-tape report(s) to identify the member firm(s) not identified on the tape report. The number of non-tape reports and the parties that appear on the non-tape report(s) depend on how the trade is reported to the tape. As illustrated below, there are three possible alternatives.

Alternative #1

Tape Report:	Firm A (capacity agent) reports a cross
Non-Tape Report #1:	Firm A (capacity agent) buys from Firm C
Non-Tape Report #2:	Firm A (capacity agent) sells to Firm B

Alternative #2

Tape Report:	Firm A (capacity agent) buys from Firm C
Non-Tape Report:	Firm A (capacity agent) sells to Firm B

Alternative #3

Tape Report:	Firm A (capacity agent) sells to Firm B
Non-Tape Report:	Firm A (capacity agent) buys from Firm C

Example #2: Firm A, as riskless principal on behalf of Firm B, and Firm C execute an OTC trade. For purposes of this example, Firm C has the obligation under FINRA rules to report the trade for tape purposes. Under the amendments, Firm A is not required to submit a non-tape report to indicate that it was acting on behalf of Firm B because Firm A is not the firm that is required to report the trade for tape purposes.

However, because Firm A is acting as riskless principal on behalf of Firm B, Firm A is required under current FINRA rules to submit a non-tape report (either a non-tape, non-clearing report or a clearing-only report) to reflect the offsetting leg of the riskless principal transaction, if the tape report submitted by Firm C does not properly reflect Firm A's capacity as riskless principal.¹²

Example #3: Firm A, as agent on behalf of Firm B, and Firm C execute an OTC trade. For purposes of this example, Firm C has the obligation under FINRA rules to report the trade for tape purposes. Under the amendments, Firm A is not required to submit a non-tape report to indicate that it was acting on behalf of Firm B because Firm A is not the firm that is required to report the trade for tape purposes.

Example #4: Firm A, as agent or riskless principal on behalf of Firm B, executes a trade on an exchange. The trade is reported to the tape by the exchange (and must not be reported to FINRA). Under the amendments, Firm A is not required to submit a non-tape report to FINRA to indicate that it was acting on behalf of Firm B; however, as is the case today, Firm A may submit a clearing-only report to clear the offsetting leg of the transaction between Firm A and Firm B through a FINRA Facility.¹³

Example #5: Firm A, as agent or riskless principal on behalf of Firm B, and Firm C execute an OTC trade. For purposes of this example, Firm A has the obligation under FINRA rules to report the trade¹⁴ and submits to FINRA a tape report between Firm A and Firm C. Under the amendments, Firm A is required to submit a non-tape report to FINRA with Firm A and Firm B represented as parties to the trade to indicate that Firm A was acting on behalf of Firm B.

Example #6: Firm A, as agent on behalf of non-member Firm B, and Firm C execute an OTC trade. For purposes of this example, Firm A has the obligation under FINRA rules to report the trade and submits to FINRA a tape report between Firm A and Firm C. Under the amendments, Firm A is not required to submit a non-tape report to FINRA to indicate that it was acting on behalf of Firm B because Firm B is a non-member.

Example #7: Firm A, as riskless principal on behalf of non-member Firm B, and Firm C execute an OTC trade. For purposes of this example, Firm A has the obligation under FINRA rules to report the trade and submits to FINRA a tape report between Firm A and Firm C. Under the amendments, Firm A is not required to submit a non-tape report to FINRA to indicate that it was acting on behalf of Firm B because Firm B is a non-member.

However, because Firm A is acting as riskless principal on behalf of Firm B, Firm A is required under current FINRA rules to properly reflect Firm A's capacity as riskless principal on the tape report. If Firm A is unable to do so, it must submit a non-tape report (either a non-tape, non-clearing report or a clearing-only report) to properly reflect the offsetting leg of the riskless principal transaction.¹⁵

FINRA notes that the submission of non-tape reports is not subject to the 90-second reporting requirement under FINRA trade reporting rules. Thus, firms generally have until the end of the day on trade date to submit the non-tape reports required under the amendments, unless a shorter reporting time is required under other FINRA rules.¹⁶

The examples above also will be included in FINRA's Trade Reporting FAQs (www.finra.org/tradereportingfaq/), which are updated periodically to address additional trade reporting scenarios as questions arise.

The amendments become effective on August 3, 2009.

Endnotes

- 1 OTC equity transactions are: (1) transactions in NMS stocks effected otherwise than on an exchange, which are reported through the Alternative Display Facility (ADF) or a Trade Reporting Facility (TRF); and (2) transactions in OTC Equity Securities (*e.g.*, OTC Bulletin Board and Pink Sheets securities), Direct Participation Program (DPP) securities and PORTAL equity securities, which are reported through the OTC Reporting Facility (ORF). The ADF, TRFs and ORF are collectively referred to herein as the “FINRA Facilities.”
- 2 See Securities Exchange Act Release No. 58903 (November 5, 2008), 73 FR 67905 (November 17, 2008) (order approving SR-FINRA-2008-011); and Securities Exchange Act Release No. 58903A (November 13, 2008), 73 FR 69700 (November 19, 2008) (correction to order approving SR-FINRA-2008-011).
- 3 The market maker-based reporting structure is as follows: (1) in transactions between two market makers, the sell-side reports; (2) in transactions between a market maker and a non-market maker, the market maker reports; (3) in transactions between two non-market makers, the sell-side reports; and (4) in transactions between a member firm and either a non-member firm or customer, the member firm reports.
- 4 See FINRA Rules 6282(b), 6380A(b), 6380B(b), 6622(b), 6633(b) and 6643(a)(3).
- 5 The rules requiring a “Reporting ECN” to ensure that trades are reported in accordance with one of three enumerated methods and to notify FINRA in writing of the method of reporting for each of its subscribers have been deleted (specifically, paragraphs (c)(5) through (7) of FINRA Rules 7230A, 7230B and 7330).
- 6 A previously executed give-up agreement may satisfy the requirement of a contemporaneously documented agreement under FINRA rules if the give-up agreement expressly states that in a manually negotiated trade between Firm A and Firm B, where Firm A as the sell-side has the reporting obligation, the parties agree that Firm B will have the reporting obligation.

It is FINRA’s understanding that firms’ current give-up agreements are not specific in this regard and, therefore, must be amended or re-executed if the parties would like to use that agreement for this purpose. If Firm A and Firm B do not have a contemporaneously documented agreement to shift the reporting obligation to Firm B, under the typical operation of a give-up agreement, Firm B can report the trade on behalf of Firm A; however, Firm A still has the trade reporting obligation under FINRA rules and is responsible for the trade report submitted on its behalf by Firm B.
- 7 For purposes of FINRA trade reporting rules applicable to equity securities, a “riskless principal” transaction is a transaction in which a firm, 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.
- 8 “Non-tape reports” are reports that are not submitted to the appropriate exclusive Securities Information Processor for public dissemination. They can be (1) “non-tape, non-clearing,” meaning that the report is submitted to FINRA solely for regulatory purposes, or (2) “clearing-only,” meaning that the report is submitted to FINRA for clearing; *i.e.*, for submission by FINRA to the National Securities Clearing Corporation (and perhaps also for regulatory purposes).

- 9 See FINRA Rules 6282(e)(1)(D), 6380A(d)(4), 6380B(d)(4), 6622(d)(4) and 6643(d)(5).
See also FINRA Rule 6633(a)(3), amended to cross-reference FINRA Rule 6622(d).
- 10 An OTC riskless principal transaction can be reported to FINRA in a single tape report properly marked as riskless principal, or in two separate reports: (1) a tape report to reflect the initial leg of the transaction and (2) a non-tape report to reflect the offsetting, “riskless” leg of the transaction, with the correct capacity of riskless principal. See FINRA Rules 6282(e)(1)(C)(ii), 6380A(d)(3)(B), 6380B(d)(3)(B) and 6622(d)(3)(B).
- 11 See *Regulatory Notice 07-38* (August 2007).
- 12 See *supra* note 10. If Firm A’s capacity is properly marked as riskless principal on the tape report, Firm A would not be required under current rules to submit a non-tape report to FINRA.
- 13 See *Regulatory Notice 07-38* (August 2007).
- 14 The most likely scenario where Firm A would have the trade reporting obligation is with respect to trades in OTC Equity Securities, as defined in FINRA Rule 6420.
- 15 See *supra* note 10. If Firm A’s capacity is properly marked as riskless principal on the tape report, Firm A would not be required under current rules to submit a non-tape report to FINRA.
- 16 See *Trade Reporting Frequently Asked Questions*, FAQ 102.2, at www.finra.org/tradereportingfaq/.