Trade Reporting Notice

Price Validation and Price-Override Protocol

September 17, 2010

Key Topic(s)

- Alternative Display Facility
- OTC Reporting Facility
- Price-Override
- Price Validation
- Trade Reporting
- Trade Reporting Facilities
- Trading Halts

Referenced Rules & Notices

- FINRA Rule 2010
- FINRA Rule 6121
- FINRA Rule 6282
- FINRA Rule 6380A
- FINRA Rule 6380B
- Regulatory Notice 10-30

Executive Summary

FINRA is issuing this Notice to explain the price validation protocol of the FINRA trade reporting facilities and to set forth new guidance on the use of the price-override indicator in trade reports. Firms are required to make systems changes necessary to report in accordance with this guidance no later than November 16, 2010.

Questions regarding this *Notice* may be directed to:

- The Legal Section, Market Regulation, at (240) 386-5126;
- FINRA Operations, at (866) 776-0800; or
- Office of General Counsel, at (202) 728-8071.

Discussion

The Alternative Display Facility (ADF) and Trade Reporting Facilities (TRFs) (collectively referred to herein as the "FINRA Facilities") price validate OTC trades in NMS stocks by comparing the submitted price against price validation parameters established by FINRA, generally based on a price deviation against the national best bid or offer.[1]

After a trade report is submitted, the FINRA Facility validates the trade price against an initial set of price validation parameters. If the trade price falls outside the parameters, the trade report is rejected, and the reporting firm can resubmit the trade with a price-override indicator. By using the price-override indicator, the reporting firm is confirming that the price it originally entered is correct, even though it is away from the current market.[2] After the trade has been resubmitted with the price-override indicator, it is price validated a second time with significantly wider parameters. If the trade is correct but outside of this second set of parameters, it must be entered manually through ADF or TRF Operations.[3]

The price validation protocol is an important check in the trade reporting process. As noted above, rejection of a trade outside the price validation parameters requires that the reporting firm confirm that the reported price is, in fact, the correct price as agreed upon by the parties. This helps reduce the likelihood that erroneously reported trade prices are disseminated to the tape.

Financial Industry Regulatory Authority

Proper trade reporting has become increasingly important because of the single-stock trading pause pilot.[4] Specifically, a firm that reports a trade with an incorrect price could trigger a trading pause in certain stocks, and trading in the stock may be unnecessarily halted, which is inconsistent with the intent and purpose of the trading pause rules. To reduce the potential for unnecessary trading halts in stocks that are eligible for the single-stock circuit breaker pilot, FINRA continues to review and make certain adjustments to the price validation parameters as necessary for these securities.

Firms must not report trades in a manner designed to circumvent this important system and operational protocol; *e.g.*, by programming their systems to automatically append the price-override indicator to their trade reports. The price-override indicator should be appended to a trade report only after the trade has been rejected by a FINRA Facility. Any firm that has programmed its systems to append the price-override indicator to its trade reports prior to rejection of the trade must make the technological changes necessary to cease this practice as soon as possible, and no later than November 16, 2010 (60 days from the date of this *Notice*).

While the single-stock circuit breaker pilot applies only to certain NMS stocks, the price validation protocol applies to reports of OTC trades in all equity securities, including OTC Equity Securities submitted to the OTC Reporting Facility (ORF). Therefore, firms must comply with the guidance set forth in this *Notice* when reporting to the ORF as well.

After November 16, 2010, a pattern and practice of reporting trades with the price-override indicator not in accordance with the established protocol and this guidance may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade in violation of FINRA Rule 2010.

Endnotes

1 A different set of parameters is applied to trades reported with a trade modifier that indicates that the price is away from the current market; *e.g.*, a modifier that indicates that the trade qualifies for an exception or exemption under Regulation NMS.

2 If the firm realizes the trade price was reported in error, then it can re-report the trade with the correct price.

3 To the extent this process (*i.e.*, rejection of the trade by the FINRA Facility and resubmission of that trade by the reporting firm) results in a late reported trade, FINRA will take this into account when enforcing the rules on timely trade reporting.

4 *See* FINRA Rule 6121 and *Regulatory Notice 10-30* (June 2010).