

Regulatory Notice

14-07

Alternative Trading Systems

SEC Approves New Requirements for Alternative Trading Systems

Implementation Dates: May 12, 2014 (ATS Reporting Requirement); November 10, 2014 (MPID Requirement)

Executive Summary

The SEC approved a rule change to require alternative trading systems (ATS) to (i) report to FINRA weekly volume information and number of securities transactions within the ATS by security and (ii) acquire and use a single, unique market participant identifier (MPID) when reporting information to FINRA.¹ The ATS reporting requirement will be implemented beginning May 12, 2014. The first ATS reports for the week of May 12 through May 16, 2014, will then be due by May 28, 2014. Each ATS must begin reporting order and trade information to FINRA using a unique MPID by November 10, 2014. This *Notice* provides more information for firms regarding each of these new requirements.

Questions concerning this *Notice* should be directed to:

- ▶ FINRA Product Management at (866) 899-2107;
- ▶ FINRA Market Operations at (866) 776-0800; or
- ▶ for legal and interpretive questions, Brant Brown, Associate General Counsel, Office of General Counsel, at (202) 728-6927.

February 2014

Notice Type

- ▶ New Rule
- ▶ Rule Amendment

Suggested Routing

- ▶ Compliance
- ▶ Institutional
- ▶ Internal Audit
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Risk
- ▶ Senior Management
- ▶ Systems
- ▶ Trading

Key Topics

- ▶ Alternative Trading Systems
- ▶ Market Participant Identifiers
- ▶ Trade Reporting

Referenced Rules & Notices

- ▶ Regulatory Notice 09-08
- ▶ FINRA Rule 4552
- ▶ FINRA Rule 6160
- ▶ FINRA Rule 6170
- ▶ FINRA Rule 6480
- ▶ FINRA Rule 6720
- ▶ FINRA Rule 7440
- ▶ SEA Rule 3b-16



Financial Industry Regulatory Authority

Background & Discussion

On January 17, 2014, the SEC approved a proposed rule change to (i) adopt FINRA Rule 4552 to require each ATS² to report to FINRA weekly volume information and number of securities transactions within the ATS (ATS reporting requirement); and (ii) amend FINRA Rules 6160, 6170, 6480 and 6720 to require each ATS to acquire and use a single, unique MPID when reporting information to FINRA (MPID requirement). As part of these new requirements, FINRA will make the reported volume and trade count information for equity securities publicly available on its website as described below. The ATS reporting requirement will be implemented beginning May 12, 2014. The first ATS reports for the week of May 12 through May 16, 2014, will then be due by May 28, 2014. Each ATS must begin reporting order and trade information to FINRA using a unique MPID by November 10, 2014.

ATS Reporting Requirement

New FINRA Rule 4552 requires each ATS that has filed a Form ATS with the SEC to report to FINRA its aggregate weekly volume information and number of trades, by security, per ATS in both equity securities and debt securities subject to FINRA trade reporting requirements.³ The ATS reporting requirement thus applies to any NMS stock,⁴ OTC Equity Security,⁵ or any debt security subject to FINRA's Trade Reporting and Compliance Engine (TRACE) rules (TRACE-eligible securities).⁶ Rule 4552 requires this information to be reported to FINRA on a security-by-security basis within seven business days after the end of each calendar week. FINRA will make the reported information for equity securities publicly available on a delayed basis as described below.

To ensure consistent reporting and to avoid potential over-counting of volume, Rule 4552 and Supplementary Material .01 specify how an ATS should calculate and report the volume of securities traded and the number of trades. Under the rule, an ATS must include only those trades executed within the ATS. If two orders are crossed by the ATS, the volume calculation would include only the number of shares or par value of bonds crossed as a single trade (*e.g.*, crossing a buy order of 1,000 shares with a sell order of 1,000 shares would be calculated as a single trade of 1,000 shares of volume). An ATS should only report trades executed within the ATS (not orders routed out of the ATS) and should only report the volume of each executed trade once (not separate or double counting for the buy and sell side of a trade).

Under Supplementary Material .01, volume is considered to be “within an ATS” for purposes of Rule 4552 if the ATS (i) executes the trade; (ii) is considered the “executing party” to the trade under FINRA rules; or (iii) otherwise matches orders constituting the trade in a manner as contemplated by SEA Rule 3b-16⁷ or SEC Regulation ATS.⁸ For example, a trade would be considered to have occurred “within an ATS” for purposes of Rule 4552 if the ATS uses established, non-discretionary methods under which orders interact with each other, and the buyers and sellers entering the orders agree to the terms of the trade.⁹ The Supplementary Material notes that this standard would include, but not be limited to:

- ▶ any trade executed as a result of the ATS bringing together the purchaser and seller on or through its system;
- ▶ any trade executed by the ATS’s subscribers where the subscribers used the ATS to negotiate the trade, even if the ATS did not itself execute the trade; or
- ▶ any trade in which the ATS takes either side of a trade for clearing or settlement or in any other way inserts itself into a trade (*e.g.*, exchanging securities or funds on behalf of one or both subscribers taking part in the trade).

If an ATS routes an order to another firm or other execution venue for handling or execution where that initial order matches against interest resident at the other venue, then the trade would not be considered “within an ATS” (*i.e.*, the ATS would not be considered to have executed the trade or to be the executing party) and would not include such volume for reporting purposes.¹⁰ In addition, if an ATS utilizes another ATS to match an order for execution (*e.g.*, by using another ATS’s messaging system), the ATS matching the order would include the transaction as volume, while the ATS initially receiving the order would not.

Dissemination of ATS Volume Information

Rule 4552 also provides that FINRA will publish on its website the reported information in each equity security for each ATS.¹¹ Initially, FINRA will publish the aggregate reported information regarding NMS stocks in Tier 1 of the NMS Plan to Address Extraordinary Market Volatility¹² on a two-week delayed basis. FINRA will publish the information on all other NMS stocks and OTC Equity Securities subject to FINRA trade reporting requirements on a four-week delayed basis. For example, a typical reporting scenario (*i.e.*, no federal holidays) would require an ATS to report the information for a given week by the second Tuesday following the week. FINRA would publish the information regarding Tier 1 NMS stocks no earlier than the following Monday. Information on all other equity securities subject to FINRA trade reporting requirements would be published two weeks following the publication of information for the Tier 1 NMS stocks.

TRACE-Eligible Securities

As noted above, the ATS reporting requirement applies to equity securities and TRACE-eligible securities. With respect to TRACE-eligible securities, a member firm that is a “party to a transaction” as defined in FINRA Rule 6710(e) must report a trade involving TRACE-eligible securities to TRACE under Rule 6730(a).¹³ A “party to a transaction” is defined as “an introducing broker-dealer, if any, an executing broker-dealer, or a customer.”¹⁴ An ATS, which includes electronic communications networks, is a party to a transaction under TRACE rules and has a trade reporting obligation when a transaction in a TRACE-eligible security is executed through the ATS.¹⁵ Similarly, FINRA equity trade reporting rules require that over-the-counter transactions between member firms be reported to FINRA by the “executing party.” “Executing party”¹⁶ is defined as the member 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. An ATS is the “executing party” and has the trade reporting obligation where the transaction is executed on the ATS.¹⁷ FINRA expects firms to follow the TRACE reporting rules and guidance, in addition to the new provisions in Rule 4552, for purposes of calculating and reporting volume in TRACE-eligible securities pursuant to the ATS reporting requirement.

Unique MPID Requirement

The SEC also approved amendments to FINRA Rules 6160, 6170, 6480 and 6720 (MPID amendments) to require each ATS to acquire and use a single, unique MPID when reporting information to FINRA. The MPID amendments require a firm operating an ATS to obtain for each such ATS a single, unique MPID that is designated for exclusive use for reporting each ATS’s transactions. A firm is not permitted to use multiple MPIDs for a single ATS, and firms that operate multiple ATSs or engage in other lines of business requiring the use of an MPID are required to obtain and use multiple MPIDs.¹⁸ Firms also must notify FINRA before changing the usage of the MPID in any way (*e.g.*, repurposing an MPID from reflecting ATS activity to other trading activity at the firm). Once a unique MPID is assigned to the particular ATS, the ATS must use such separate MPID to report all transactions executed within the ATS to the appropriate reporting facility (*e.g.*, a FINRA Trade Reporting Facility, the Alternative Display Facility, the OTC Reporting Facility, TRACE), and any order information required to be reported to the Order Audit Trail System (OATS) must include the MPID assigned to the particular ATS.¹⁹ The MPID amendments prohibit a firm from using a separate MPID assigned to an ATS to report any transaction that is not executed within the ATS and require firms to have policies and procedures in place to ensure that trades reported with a separate MPID obtained under the rules are restricted to trades executed within the ATS.

As noted in the filing with the SEC, FINRA will evaluate the ATS reporting requirement after the MPID amendments are implemented to determine whether reporting continues to be necessary. If the MPID amendments are operating as anticipated, FINRA will eliminate the weekly ATS reporting requirement for an ATS subject to FINRA trade reporting requirements.²⁰ For an ATS already using a separate MPID, FINRA believes weekly reporting is still necessary for comparison purposes; thus, initially, each ATS will be required to report volume information to FINRA under Rule 4552 even if it already uses a unique MPID for reporting information to FINRA.

Reporting Specifications and Information

Each ATS will report the weekly information required by Rule 4552 to FINRA via the Secure File Transfer Protocol (SFTP). To submit files via SFTP, an ATS must (i) have an FTP account set up with ATS File Transfer privileges and (ii) request an ATS identifier. If an ATS does not already have an FTP account with FINRA, it must submit a request to create an FTP account. If an ATS already has an FTP account, it must add the ATS File Transfer privilege to that account. Each ATS will be required to submit the file of its weekly volume data in a pre-defined format as defined by FINRA in the Alternative Trading System (ATS) Transparency Trade Report File Specification and User Guide, which is available on the [ATS Transparency pages](#). For information about requesting FTP accounts or adding FTP account privileges, refer to [Entitlement Information for FTP Users](#). Please note that the revised form with the new ATS File Transfer privilege will be available before implementation. If you have questions concerning FINRA Entitlement, please refer to the [FINRA Entitlement Program](#) or contact the FINRA Entitlement Group, at (240) 386-4185 or the FINRA Gateway Call Center at (301) 869-6699.

Although an ATS is not required to begin using a unique MPID for trade reporting until November 10, 2014, each ATS will need to submit a completed FINRA MPID Request Form²¹ to FINRA Market Operations prior to submitting trade data pursuant to Rule 4552. The FINRA MPID Request Form will allow an ATS to request a unique identifier so it can submit data files to FINRA with this identifier.²² The identifier will then serve as the unique MPID for an ATS once the MPID requirement goes into effect. Once an ATS has received authorization for its FTP account and has been provided with its identifier, it will be able to submit its data to FINRA via SFTP.

Endnotes

1. See Securities Exchange Act Release No. 71341 (January 17, 2014), 79 FR 4213 (January 24, 2014) (Order Approving SR-FINRA-2013-042).
2. Regulation ATS defines an “alternative trading system” as “any organization, association, person, group of persons, or system: (1) That constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of [Exchange Act Rule 3b-16]; and (2) That does not: (i) Set rules governing the conduct of subscribers other than the conduct of such subscribers’ trading on such organization, association, person, group of persons, or system; or (ii) Discipline subscribers other than by exclusion from trading.” 17 CFR 242.300(a). Rule 4552 and the amendments discussed in this *Notice* apply to any alternative trading system, as that term is defined in Regulation ATS, that has filed a Form ATS with the SEC.
3. An ATS that has received an exemption from FINRA to permit its subscribers to report trades to FINRA must still submit a weekly volume report. See FINRA Rules 6183, 6625 and 6731. An ATS is also required to submit a weekly report for weeks where the ATS has no volume. In these instances, the ATS would affirmatively indicate no volume on the report.
4. See FINRA Rule 6110.
5. See FINRA Rule 6410.
6. See FINRA Rules 6710, 6730(a).
7. See 17 CFR 240.3b-16.
8. See 17 CFR 242.300 et seq.
9. See 17 CFR 240.3b-16(a)(2).
10. If, however, an ATS matches orders but routes those orders to another execution venue for execution and dissemination, the trade would be considered to have occurred “within the ATS” and would count as volume of the ATS for reporting purposes.
11. FINRA will be submitting a proposed rule change to the SEC to establish a fee for professional users of the data to recover costs that may be incurred in providing the information; however, non-professional users can receive the data free of charge.
12. Tier 1 NMS stocks include those NMS stocks in the S&P 500 Index or the Russell 1000 Index and certain ETPs. See NMS Plan to Address Extraordinary Market Volatility. FINRA will make changes to the Tier 1 NMS stocks in accordance with the indices. Changes to the S&P 500 are made on an as needed basis and are not subject to an annual or semi-annual reconstitution. S&P typically does not add new issues until they have been seasoned for six to twelve months. Russell 1000 rebalancing typically takes place in June.
13. In transactions between member firms, each firm must report the trade, and for transactions between a member firm and a customer, the member firm must report the trade. See Rule 6730(a).
14. Under Rule 6710(e), “customer” includes a broker-dealer that is not a FINRA member.
15. See question 7.4 under the [Reporting of Corporate and Agencies Debt Frequently Asked Questions](#).
16. See Rules 6282, 6380A, 6380B and 6622.

17. See Securities Exchange Act Release No. 58903 (November 5, 2008), 73 FR 67905 (November 17, 2008) (Order Approving File No. SR-FINRA-2008-011); and [Regulatory Notice 09-08](#) (January 2009). See also, e.g., [Trade Reporting Frequently Asked Questions](#), Sections 203, 307 and 308.
18. In 2010, FINRA adopted amendments to Rule 6160 establishing a voluntary program to allow firms operating an ATS dark pool to have their daily aggregate trading data published by the TRFs. See Securities Exchange Act Release No. 61658 (March 5, 2010), 75 FR 11972 (March 12, 2010). To date, no firm has voluntarily taken part in the program. Under Rule 6160(c), firms voluntarily participating in the program are required to obtain and use a separate MPID designated exclusively for the reporting of transactions executed within the ATS dark pool, which is defined as “an ATS that does not display quotations or subscribers’ orders to any person or entity either internally within the ATS dark pool or externally beyond the ATS dark pool (other than employees of the ATS).” See FINRA Rule 6160(c). Because the MPID amendments require the use of a single, unique MPID for all ATS, Rule 6160(c) was amended to expand the MPID requirement to all ATSs; however, FINRA is maintaining the provisions specific to the ATS dark pool program in Supplementary Material .02 to Rule 6160 with some minor changes to incorporate defined terms and to adjust cross-references.
19. OATS Reporting Members are required to include an MPID on OATS reports. See, e.g., FINRA Rule 7440(b)(3), (c)(1)(B), (c)(2)(A)(ii), (c)(2)(A)(iii). FINRA has not amended the OATS rules in connection with the MPID requirement; however, current OATS guidance provides that “[a]n order that is transferred between two valid MPIDs within the same firm is also considered routed.” See *OATS Reporting Technical Specifications*, at 4-3 (ed. December 11, 2012). Consequently, after the MPID requirement is implemented, an order routed to an ATS will require the submission of a Route Report, which must reflect the unique MPID of the ATS to which the order was routed. See FINRA Rule 7440(c).
20. An ATS that meets specified criteria can apply for an exemption from its trade reporting obligations. See FINRA Rules 6183, 6625 and 6731. Any ATS that is granted an exemption will likely need to continue to report, even after the MPID requirement is implemented, because its volume will not be captured by the use of a unique MPID in trade reports. The terms of the exemption already require exempt ATSs to provide FINRA with data relating to the volume of trades by security executed by the ATS’s member subscribers using the ATS’s system. FINRA is also considering making another field available on trade reports to identify the exempt ATS in those circumstances, but only in the limited circumstance where the ATS has been granted an exemption to its trade reporting obligations under Rule 6183, 6625 or 6731.
21. The FINRA MPID Request Form is not yet available. When available, it will be posted to the [ATS Transparency page](#).
22. An ATS that already has an existing unique MPID is still required to complete a FINRA MPID Request Form to identify the MPID that will be used by the ATS for weekly reporting purposes.