

OMB APPROVAL

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2011 - * 063

Amendment No. (req. for Amendments *)

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

Initial * ☒ Amendment * ☐ Withdrawal ☐

Section 19(b)(2) * ☒ Section 19(b)(3)(A) * ☐ Section 19(b)(3)(B) * ☐

Rule

Pilot ☐ Extension of Time Period
for Commission Action * ☐ Date Expires *

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

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

Proposed Rule Change Relating to Amendments to the Order Audit Trail System Rules

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 proposed rule change.

First Name * Brant Last Name * Brown
Title * Associate General Counsel
E-mail * brant.brown@finra.org
Telephone * (202) 728-6927 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 officer.

Date 10/28/2011

By Stephanie Dumont
(Name *)

Senior Vice President and Director of Capital Markets
Policy

(Title *)

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.

Stephanie Dumont,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

Form 19b-4 Information (required)

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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 (required)

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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 2 - Notices, Written Comments, Transcripts, Other Communications

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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

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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

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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

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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

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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 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 (i) amend Rules 5320 and 7440 to require that members report to the Order Audit Trail System (“OATS”) information barriers put into place by the member in reliance on Supplementary Material .02 to Rule 5320; (ii) amend Rule 7440 to require that members report customer instructions regarding the display of a customer’s limit order in any OATS-eligible security; and (iii) amend Rule 7450 to codify the specific time OATS reports must be transmitted to FINRA.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

* * * * *

5300. HANDLING OF CUSTOMER ORDERS

* * * * *

5320. Prohibition Against Trading Ahead of Customer Orders

(a) through (b) No Change.

• • • **Supplementary Material:** -----

.01 No Change.

¹ 15 U.S.C. 78s(b)(1).

.02 No-Knowledge Exception

(a) through (b) No Change.

(c) If a member implements and utilizes appropriate information barriers in reliance on this exception, the member must uniquely identify such information barriers as prescribed in Rule 7440(b)(19).

* * * * *

**7000. CLEARING, TRANSACTION AND ORDER DATA REQUIREMENTS,
AND FACILITY CHARGES**

* * * * *

7400. ORDER AUDIT TRAIL SYSTEM

* * * * *

7440. Recording of Order Information

(a) No Change.

(b) Order Origination and Receipt

Unless otherwise indicated, the following order information must be recorded under this Rule when an order is received or originated. For purposes of this Rule, the order origination or receipt time is the time the order is received from the customer.

(1) through (13) No Change.

(14) any request by a customer that a[n] limit order not be displayed, or that a block size limit order be displayed, pursuant to [Rule 604(b) of SEC Regulation NMS] applicable rules;

(15) through (16) No Change.

(17) an identification of the order as related to a Program Trade or an Index Arbitrage Trade; [and]

(18) the type of account, i.e., retail, wholesale, employee, proprietary, or any other type of account designated by FINRA, for which the order is submitted; and[.]

(19) if the member is relying on the exception provided in Rule 5320.02 with respect to the order, the unique identification of any appropriate information barriers in place at the department within the member where the order was received or originated.

(c) Order Transmittal

Order information required to be recorded under this Rule when an order is transmitted include the following.

(1) When a Reporting Member transmits an order to a department within the member, the Reporting Member shall record:

(A) through (E) No Change.

(F) the number of shares to which the transmission applies, [and]

(G) any special handling requests, and[.]

(H) if the member is relying on the exception provided in Rule 5320.02 with respect to the order, the unique identification of any appropriate information barriers in place at the department within the member to which the order was transmitted.

(2) through (6) No Change.

(d) No Change.

* * * * *

7450. Order Data Transmission Requirements

(a) No Change.

(b) Method and Timing of Transmitting Data

(1) No Change.

(2) Each Reporting Member shall transmit to the Order Audit Trail System a report containing each applicable item of order information identified in Rule 7440(b), (c), and (d) whenever an order is originated, received, transmitted to another department within the member or to another member, modified, canceled, or executed. [Each report shall be transmitted on the day such event occurred;] The Reporting Member must transmit reports of all order events occurring on an OATS Business Day by 8:00 a.m. Eastern Time on the calendar day following the end of the OATS Business Day; provided, however, that if any item of information required to be reported [identified in Rule 7440(b), (c), and (d)] is not available by the time the report must be transmitted, [on such day,] then the report shall be transmitted on the day that all such items of information become available. [Order information reports may be aggregated into one or more transmissions, during such business hours as may be prescribed by FINRA.]

(3) For purposes of this paragraph, an “OATS Business Day” begins at 4:00:01 p.m. Eastern Time on one market day and ends at 4:00:00 p.m. Eastern Time on the next market day.

(c) No Change.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on July 14, 2011, the FINRA Board of Governors authorized the filing of the proposed rule change regarding reporting information barriers to OATS with the SEC. The proposed rule change regarding reporting customer instructions on limit orders to OATS and the amendments to Rule 7450 have been approved by the General Counsel of FINRA (or his officer designee) pursuant to delegated authority. No other action by FINRA is necessary for the filing of the proposed rule change.

The effective date of the proposed rule change will be no later than 120 days after Commission approval.

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

(a) Purpose

FINRA is proposing two changes to the order recording requirements in Rule 7440 of the OATS rules to reflect two recent amendments to other FINRA rules. First, the proposed rule change requires members relying on the "No-Knowledge Exception" in Supplementary Material .02 to Rule 5320 (Prohibition Against Trading Ahead of Customer Orders) to report information to OATS regarding the information barriers adopted by the member in reliance on the exception. The proposed rule change also adds this requirement into Supplementary Material .02 of Rule 5320. Second, the proposed rule change extends the existing requirement to reflect on OATS reports a customer's instruction regarding display of the customer's limit orders. The requirement currently

applies only to limit orders involving NMS stocks; the proposed rule change extends the requirement to all OATS-eligible securities.

FINRA is also proposing amendments to Rule 7450 to codify the specific time by which OATS reports must be transmitted to FINRA.

(1) Customer Order Protection

First, FINRA is proposing to require members to identify on OATS reports information barriers that the member has in place in reliance on the No-Knowledge Exception in Supplementary Material .02 to Rule 5320.

On February 11, 2011, the SEC approved FINRA's proposed rule change to consolidate NASD Rule 2111 and IM-2110-2 into new FINRA Rule 5320.² Under Rule 5320, a member that accepts and holds an order in an equity security from its own customer, or a customer of another broker-dealer, without immediately executing the order is prohibited from trading that security on the same side of the market for its own proprietary account at a price that would satisfy the customer order unless the member immediately thereafter executes the customer order up to the size and at the same, or better, price at which the member traded for its proprietary account. The No-Knowledge Exception in Supplementary Material .02 to Rule 5320 provides that if a firm implements and uses an effective system of internal controls—such as appropriate information barriers—that operate to prevent one trading unit from obtaining knowledge of customer orders held by a separate trading unit, those other trading units may trade in a proprietary capacity at prices that would satisfy the customer orders held by the separate, walled-off trading unit.

² See Securities Exchange Act Release No. 63895 (February 11, 2011), 76 FR 9386 (February 17, 2011).

When FINRA originally proposed Rule 5320, members claiming the No-Knowledge Exception would have been required to assign and use a unique market participant identifier (“MPID”) for any walled-off market-making desk.³ In response to commenters’ concerns with the proposed MPID requirement, FINRA amended the proposal to delete the unique MPID requirement, but stated that it intended to examine alternative means of achieving the same regulatory objective of being able to determine on an automated basis those customer orders that are received from walled-off desks.⁴ The proposed rule change accomplishes the objective by adding provisions to the No-Knowledge Exception and to Rule 7440 that require firms relying on the exception to identify the information barriers to FINRA in their OATS reports.⁵

Through the use of OATS, FINRA will be able to ascertain, on an automated basis, those firms claiming the No-Knowledge Exception. This will reduce the potential for “false positive” alerts by allowing FINRA to account for the existence of information barriers when running automated surveillance patterns designed to identify inappropriate trading ahead of customer orders. FINRA believes that the new requirements will

³ See Securities Exchange Act Release No. 61168 (December 15, 2009), 74 FR 68084 (December 22, 2009).

⁴ See Securities Exchange Act Release No. 63895 (February 11, 2011), 76 FR 9386 (February 17, 2011).

⁵ Members are permitted to report this information to OATS on a voluntary basis. See OATS Reporting Technical Specifications, at iii (ed. May 3, 2011); see also OATS for all NMS Stocks Frequently Asked Questions, Question 12, available at www.finra.org/oats. FINRA has encouraged members to do so to avoid “false positive” results that can be caused by automated surveillance patterns aggregating trading data without regard to information barriers that firms have put in place pursuant to the No-Knowledge Exception. See Regulatory Notice 11-24, n.12 (May 2011). The proposed rule change would make reporting of the information mandatory for those members relying on the No-Knowledge Exception.

substantially reduce the number of “false positives” that are identified through automated surveillance patterns by being able to account for information barriers when trading ahead may otherwise be indicated.

(2) Limit Order Display

Rule 7440(b)(14) requires OATS Reporting Members to identify “any request by a customer that an order not be displayed, or that a block size order be displayed, pursuant to Rule 604(b) of SEC Regulation NMS.”⁶ These customer requests are identified in the OATS system through a “Customer Instruction Flag” that indicates whether the customer has requested that the firm handle its limit order in a specified way. Because of the reference in Rule 7440(b)(14) to SEC Regulation NMS, members are only required to populate the Customer Instruction Flag when the order involves a security subject to SEC Regulation NMS.

On June 22, 2010, the Commission approved Rule 6460,⁷ which became effective on May 9, 2011.⁸ Rule 6460 generally requires OTC market makers to display a customer limit order in an OTC equity security held by the OTC market maker that is at a price that would improve the bid or offer of such OTC market maker in such security or

⁶ Rule 604 of SEC Regulation NMS generally requires OTC market makers in NMS stocks to display customer limit orders that would improve the market maker’s published bid or offer (either by price or size). See 17 CFR 242.604(a)(2). Rule 604(b)(2) of SEC Regulation NMS excepts from the display requirement any customer limit order that is placed by a customer who expressly requests that the order not be displayed. See 17 CFR 242.604(b)(2). Rule 604(b)(4) of SEC Regulation NMS excepts from the display requirement any customer limit order of block size unless the customer requests that the order be displayed. See 17 CFR 242.604(b)(4).

⁷ See Securities Exchange Act Release No. 62359 (June 22, 2010), 75 FR 37488 (June 29, 2010).

⁸ See Regulatory Notice 10-42 (September 2010).

that would represent more than a de minimis change in relation to the size associated with the OTC market maker's bid or offer. Rule 6460(b) includes exceptions to the display requirement for OTC equity securities that mirror the exceptions in Rule 604(b) of SEC Regulation NMS.⁹

FINRA is proposing to require that OATS Reporting Members indicate on all OATS reports for customer limit orders, including OTC equity securities, whether the customer has instructed the member not to display the limit order or to display a limit order of block size. As a result, OATS Reporting Members would be required to populate the Customer Instruction Flag for all limit orders, not just those involving NMS stocks. Use of the Customer Instruction Flag for all limit orders reported to OATS will notify FINRA that a customer has requested display of a limit order that would not otherwise be required to be displayed under applicable rules as well as avoid potential “false positives” generated by customer limit orders that are not being displayed due to the customer’s request.

(3) Order Data Transmission Requirements

Rule 7450 requires members to report order information recorded pursuant to Rule 7440. Paragraph (a) of the rule imposes the general requirement that members report applicable order information to FINRA that the member is required to record by Rule 7440. Paragraph (b) of the rule addresses the form the order data must take and the timing of order reports. Paragraph (c) concerns the use of reporting agent agreements that a member may use to allow a third party to report information to OATS on behalf of the member. The proposed rule change amends paragraph (b) of Rule 7450 to codify the

⁹ See FINRA Rule 6460(b)(2), (b)(4).

specific time OATS reports must be transmitted to FINRA, which is the same time that currently is required under the OATS Reporting Technical Specifications, as described in more detail below.

Rule 7450(b) provides that, generally, reports should be transmitted on the day of the order event unless information is not available.¹⁰ In addition, if the member aggregates information, the information must be transmitted “during such business hours as may be prescribed by FINRA.”

The proposed rule change would update the language in the rule, which has not been changed substantially since it was adopted in 1998, and codify a specific deadline that members must meet. When the rule language was adopted, and before OATS reporting was implemented in 1999, the rule language acknowledged that firms could choose to report OATS data to FINRA on a rolling basis throughout the day, or reports could be aggregated into one or more transmissions and submitted “during such business hours as may be prescribed by [FINRA].” This rule language further reflected the fact that, at the time the rules were proposed, issues involving the capacity of OATS and technological changes could affect the manner and timing of transmitting order information to OATS. In its initial filing with the Commission, FINRA noted:

Based on further development of the Order Audit System and determinations relating to system capacity and other factors, NASDR will

¹⁰ FINRA announced that OATS reports would be marked late if submitted after 8:00 a.m. Eastern Time on the calendar day following the OATS Business Day on which the order event occurred in the May 3, 2011 edition of the OATS Reporting Technical Specifications. See OATS Reporting Technical Specifications, at 8-1 (ed. May 3, 2011). Previously, OATS reports were marked late if received after 5:00 a.m. Eastern Time. See OATS Reporting Technical Specifications, at 8-1 (ed. November 8, 2010); Letter from Brant Brown, Associate General Counsel, FINRA, to Elizabeth Murphy, Secretary, SEC (October 28, 2010) relating to SR-FINRA-2010-044.

prescribe the hours during which information may be transmitted. The prescribed hours likely will extend past the end of the trading day. The proposal contemplates that all Order information, along with corresponding ACT data that has been integrated with such information, will be available to NASDR staff at the beginning of the trading day following the day on which the information has been transmitted.¹¹

FINRA (then NASDR) began testing the capabilities of its systems in August 1998 in anticipation of the implementation of Phase One of OATS in early 1999.¹² In the November 30, 1998 version of the OATS Reporting Technical Specifications, FINRA prescribed that, for purposes of OATS reporting, an OATS business day would begin after the close of the Nasdaq Stock Market on one market day (4:00:01 p.m. Eastern Time) and end with the close of the Nasdaq Stock Market on the next market day (4:00:00 p.m. Eastern Time). Orders received during an OATS business day would be required to be submitted to OATS by 4:00:00 a.m. Eastern Time the following calendar day.¹³ This was intended to provide firms with adequate time to aggregate data files and transmit them to FINRA before the beginning of the next trading day.

FINRA is proposing to replace the current rule language regarding the timing of OATS transmissions to FINRA with a specific requirement. Under the proposed rule, all order events that occur on a particular OATS Business Day must be transmitted to FINRA by 8:00 a.m. Eastern Time on the calendar day following the end of the OATS

¹¹ See Securities Exchange Act Release No. 38990 (August 28, 1997), 62 FR 47096, 47103 (September 5, 1997) (Notice of Filing of Proposed Rule Change SR-NASD-97-56).

¹² See SR-NASD-97-56, Amendment No. 4; NASD Special Notice to Members 98-33 (March 1998).

¹³ See NASD Notice to Members 99-04 (January 1999). FINRA extended the time from 4:00 a.m. Eastern Time to 5:00 a.m. Eastern Time in 2007 connection with the expansion of OATS to OTC equity securities. See August 21, 2007 Addendum to OATS Reporting Technical Specifications (ed. August 6, 2007).

Business Day. For purposes of the rule, an “OATS Business Day” begins at 4:00:01 p.m. Eastern Time on one market day and ends at 4:00:00 p.m. Eastern Time on the next market day.¹⁴ FINRA is retaining the exception for information that is not available by the time the report must be transmitted; in such cases, the report must be transmitted on the day that the information becomes available.¹⁵

As noted in Item 2 of this filing, the effective date of the proposed rule change will be no later than 120 days after Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁶ 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

¹⁴ Thus, for example, assuming no holidays, if an order is received at 5:00:00 p.m. Eastern Time on Wednesday, the order event occurs on the OATS Business Day ending Thursday at 4:00:00 p.m. Eastern Time. Receipt of the order (and any subsequent event(s) regarding the order until Thursday at 4:00:00 p.m. Eastern Time) must be reported by 8:00:00 a.m. on Friday. Order events occurring on market days during regular market hours (i.e., before 4:00:01 p.m. Eastern Time) are reported by 8:00:00 a.m. Eastern Time on the following calendar day.

¹⁵ This provision was initially intended to address circumstances where complete information is not available at the time an order report must be submitted (for example, where an order is executed over the course of multiple days, and the total execution information is not available on the same day the order is received). See Securities Exchange Act Release No. 38990 (August 28, 1997), 62 FR 47096 (September 5, 1997). The provision was amended in 2006 to also address circumstances where a firm has traded a security that has not been assigned a symbol and can report the information only after a symbol has been requested, which must be done promptly, and assigned. See Securities Exchange Act Release No. 54585 (October 10, 2006), 71 FR 61112 (October 17, 2006); Notice to Members 06-70 (December 2006).

¹⁶ 15 U.S.C. 78o-3(b)(6).

interest. FINRA believes that the proposed rule change will enhance FINRA's automated surveillance systems by providing customer instruction information relating to limit orders and significantly reducing the incidence of "false positive" results caused by identifying permitted trading activity in automated surveillance patterns. By reducing "false positive" results, FINRA can focus its resources on trading activity that has properly been identified as warranting further regulatory scrutiny, thus promoting just and equitable principles of trade and protecting investors and the public interest. FINRA also believes that codifying the time by which OATS reports must be submitted will promote just and equitable principles of trade by ensuring that all members are aware of their reporting obligations.

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.

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

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.¹⁷

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

Not applicable.

¹⁷ 15 U.S.C. 78s(b)(2).

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

Not applicable.

9. Exhibits

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

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2011-063)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to Amendments to the Order Audit Trail System Rules

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. 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 (i) Rules 5320 and 7440 to require that members report to the Order Audit Trail System (“OATS”) information barriers put into place by the member in reliance on Supplementary Material .02 to Rule 5320; (ii) Rule 7440 to require that members report customer instructions regarding the display of a customer’s limit order in any OATS-eligible security; and (iii) Rule 7450 to codify the specific time OATS reports must be transmitted to FINRA.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

FINRA is proposing two changes to the order recording requirements in Rule 7440 of the OATS rules to reflect two recent amendments to other FINRA rules. First, the proposed rule change requires members relying on the "No-Knowledge Exception" in Supplementary Material .02 to Rule 5320 (Prohibition Against Trading Ahead of Customer Orders) to report information to OATS regarding the information barriers adopted by the member in reliance on the exception. The proposed rule change also adds this requirement into Supplementary Material .02 of Rule 5320. Second, the proposed rule change extends the existing requirement to reflect on OATS reports a customer's instruction regarding display of the customer's limit orders. The requirement currently applies only to limit orders involving NMS stocks; the proposed rule change extends the requirement to all OATS-eligible securities.

FINRA is also proposing amendments to Rule 7450 to codify the specific time by which OATS reports must be transmitted to FINRA.

(1) Customer Order Protection

First, FINRA is proposing to require members to identify on OATS reports information barriers that the member has in place in reliance on the No-Knowledge Exception in Supplementary Material .02 to Rule 5320.

On February 11, 2011, the SEC approved FINRA's proposed rule change to consolidate NASD Rule 2111 and IM-2110-2 into new FINRA Rule 5320.³ Under Rule 5320, a member that accepts and holds an order in an equity security from its own customer, or a customer of another broker-dealer, without immediately executing the order is prohibited from trading that security on the same side of the market for its own proprietary account at a price that would satisfy the customer order unless the member immediately thereafter executes the customer order up to the size and at the same, or better, price at which the member traded for its proprietary account. The No-Knowledge Exception in Supplementary Material .02 to Rule 5320 provides that if a firm implements and uses an effective system of internal controls—such as appropriate information barriers—that operate to prevent one trading unit from obtaining knowledge of customer orders held by a separate trading unit, those other trading units may trade in a proprietary capacity at prices that would satisfy the customer orders held by the separate, walled-off trading unit.

When FINRA originally proposed Rule 5320, members claiming the No-Knowledge Exception would have been required to assign and use a unique market

³ See Securities Exchange Act Release No. 63895 (February 11, 2011), 76 FR 9386 (February 17, 2011).

participant identifier (“MPID”) for any walled-off market-making desk.⁴ In response to commenters’ concerns with the proposed MPID requirement, FINRA amended the proposal to delete the unique MPID requirement, but stated that it intended to examine alternative means of achieving the same regulatory objective of being able to determine on an automated basis those customer orders that are received from walled-off desks.⁵ The proposed rule change accomplishes the objective by adding provisions to the No-Knowledge Exception and to Rule 7440 that require firms relying on the exception to identify the information barriers to FINRA in their OATS reports.⁶

Through the use of OATS, FINRA will be able to ascertain, on an automated basis, those firms claiming the No-Knowledge Exception. This will reduce the potential for “false positive” alerts by allowing FINRA to account for the existence of information barriers when running automated surveillance patterns designed to identify inappropriate trading ahead of customer orders. FINRA believes that the new requirements will substantially reduce the number of “false positives” that are identified through automated

⁴ See Securities Exchange Act Release No. 61168 (December 15, 2009), 74 FR 68084 (December 22, 2009).

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⁶ Members are permitted to report this information to OATS on a voluntary basis. See OATS Reporting Technical Specifications, at iii (ed. May 3, 2011); see also OATS for all NMS Stocks Frequently Asked Questions, Question 12, available at www.finra.org/oats. FINRA has encouraged members to do so to avoid “false positive” results that can be caused by automated surveillance patterns aggregating trading data without regard to information barriers that firms have put in place pursuant to the No-Knowledge Exception. See Regulatory Notice 11-24, n.12 (May 2011). The proposed rule change would make reporting of the information mandatory for those members relying on the No-Knowledge Exception.

surveillance patterns by being able to account for information barriers when trading ahead may otherwise be indicated.

(2) Limit Order Display

Rule 7440(b)(14) requires OATS Reporting Members to identify “any request by a customer that an order not be displayed, or that a block size order be displayed, pursuant to Rule 604(b) of SEC Regulation NMS.”⁷ These customer requests are identified in the OATS system through a “Customer Instruction Flag” that indicates whether the customer has requested that the firm handle its limit order in a specified way. Because of the reference in Rule 7440(b)(14) to SEC Regulation NMS, members are only required to populate the Customer Instruction Flag when the order involves a security subject to SEC Regulation NMS.

On June 22, 2010, the Commission approved Rule 6460,⁸ which became effective on May 9, 2011.⁹ Rule 6460 generally requires OTC market makers to display a customer limit order in an OTC equity security held by the OTC market maker that is at a price that would improve the bid or offer of such OTC market maker in such security or that would represent more than a de minimis change in relation to the size associated with

⁷ Rule 604 of SEC Regulation NMS generally requires OTC market makers in NMS stocks to display customer limit orders that would improve the market maker’s published bid or offer (either by price or size). See 17 CFR 242.604(a)(2). Rule 604(b)(2) of SEC Regulation NMS excepts from the display requirement any customer limit order that is placed by a customer who expressly requests that the order not be displayed. See 17 CFR 242.604(b)(2). Rule 604(b)(4) of SEC Regulation NMS excepts from the display requirement any customer limit order of block size unless the customer requests that the order be displayed. See 17 CFR 242.604(b)(4).

⁸ See Securities Exchange Act Release No. 62359 (June 22, 2010), 75 FR 37488 (June 29, 2010).

⁹ See Regulatory Notice 10-42 (September 2010).

the OTC market maker's bid or offer. Rule 6460(b) includes exceptions to the display requirement for OTC equity securities that mirror the exceptions in Rule 604(b) of SEC Regulation NMS.¹⁰

FINRA is proposing to require that OATS Reporting Members indicate on all OATS reports for customer limit orders, including OTC equity securities, whether the customer has instructed the member not to display the limit order or to display a limit order of block size. As a result, OATS Reporting Members would be required to populate the Customer Instruction Flag for all limit orders, not just those involving NMS stocks. Use of the Customer Instruction Flag for all limit orders reported to OATS will notify FINRA that a customer has requested display of a limit order that would not otherwise be required to be displayed under applicable rules as well as avoid potential “false positives” generated by customer limit orders that are not being displayed due to the customer’s request.

(3) Order Data Transmission Requirements

Rule 7450 requires members to report order information recorded pursuant to Rule 7440. Paragraph (a) of the rule imposes the general requirement that members report applicable order information to FINRA that the member is required to record by Rule 7440. Paragraph (b) of the rule addresses the form the order data must take and the timing of order reports. Paragraph (c) concerns the use of reporting agent agreements that a member may use to allow a third party to report information to OATS on behalf of the member. The proposed rule change amends paragraph (b) of Rule 7450 to codify the specific time OATS reports must be transmitted to FINRA, which is the same time that

¹⁰ See FINRA Rule 6460(b)(2), (b)(4).

currently is required under the OATS Reporting Technical Specifications, as described in more detail below.

Rule 7450(b) provides that, generally, reports should be transmitted on the day of the order event unless information is not available.¹¹ In addition, if the member aggregates information, the information must be transmitted “during such business hours as may be prescribed by FINRA.”

The proposed rule change would update the language in the rule, which has not been changed substantially since it was adopted in 1998, and codify a specific deadline that members must meet. When the rule language was adopted, and before OATS reporting was implemented in 1999, the rule language acknowledged that firms could choose to report OATS data to FINRA on a rolling basis throughout the day, or reports could be aggregated into one or more transmissions and submitted “during such business hours as may be prescribed by [FINRA].” This rule language further reflected the fact that, at the time the rules were proposed, issues involving the capacity of OATS and technological changes could affect the manner and timing of transmitting order information to OATS. In its initial filing with the Commission, FINRA noted:

Based on further development of the Order Audit System and determinations relating to system capacity and other factors, NASDR will prescribe the hours during which information may be transmitted. The prescribed hours likely will extend past the end of the trading day. The

¹¹ FINRA announced that OATS reports would be marked late if submitted after 8:00 a.m. Eastern Time on the calendar day following the OATS Business Day on which the order event occurred in the May 3, 2011 edition of the OATS Reporting Technical Specifications. See OATS Reporting Technical Specifications, at 8-1 (ed. May 3, 2011). Previously, OATS reports were marked late if received after 5:00 a.m. Eastern Time. See OATS Reporting Technical Specifications, at 8-1 (ed. November 8, 2010); Letter from Brant Brown, Associate General Counsel, FINRA, to Elizabeth Murphy, Secretary, SEC (October 28, 2010) relating to SR-FINRA-2010-044.

proposal contemplates that all Order information, along with corresponding ACT data that has been integrated with such information, will be available to NASDR staff at the beginning of the trading day following the day on which the information has been transmitted.¹²

FINRA (then NASDR) began testing the capabilities of its systems in August 1998 in anticipation of the implementation of Phase One of OATS in early 1999.¹³ In the November 30, 1998 version of the OATS Reporting Technical Specifications, FINRA prescribed that, for purposes of OATS reporting, an OATS business day would begin after the close of the Nasdaq Stock Market on one market day (4:00:01 p.m. Eastern Time) and end with the close of the Nasdaq Stock Market on the next market day (4:00:00 p.m. Eastern Time). Orders received during an OATS business day would be required to be submitted to OATS by 4:00:00 a.m. Eastern Time the following calendar day.¹⁴ This was intended to provide firms with adequate time to aggregate data files and transmit them to FINRA before the beginning of the next trading day.

FINRA is proposing to replace the current rule language regarding the timing of OATS transmissions to FINRA with a specific requirement. Under the proposed rule, all order events that occur on a particular OATS Business Day must be transmitted to FINRA by 8:00 a.m. Eastern Time on the calendar day following the end of the OATS Business Day. For purposes of the rule, an “OATS Business Day” begins at 4:00:01 p.m.

¹² See Securities Exchange Act Release No. 38990 (August 28, 1997), 62 FR 47096, 47103 (September 5, 1997) (Notice of Filing of Proposed Rule Change SR-NASD-97-56).

¹³ See SR-NASD-97-56, Amendment No. 4; NASD Special Notice to Members 98-33 (March 1998).

¹⁴ See NASD Notice to Members 99-04 (January 1999). FINRA extended the time from 4:00 a.m. Eastern Time to 5:00 a.m. Eastern Time in 2007 connection with the expansion of OATS to OTC equity securities. See August 21, 2007 Addendum to OATS Reporting Technical Specifications (ed. August 6, 2007).

Eastern Time on one market day and ends at 4:00:00 p.m. Eastern Time on the next market day.¹⁵ FINRA is retaining the exception for information that is not available by the time the report must be transmitted; in such cases, the report must be transmitted on the day that the information becomes available.¹⁶

The effective date of the proposed rule change will be no later than 120 days after Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁷ 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 believes that the proposed rule change will enhance FINRA's automated

¹⁵ Thus, for example, assuming no holidays, if an order is received at 5:00:00 p.m. Eastern Time on Wednesday, the order event occurs on the OATS Business Day ending Thursday at 4:00:00 p.m. Eastern Time. Receipt of the order (and any subsequent event(s) regarding the order until Thursday at 4:00:00 p.m. Eastern Time) must be reported by 8:00:00 a.m. on Friday. Order events occurring on market days during regular market hours (i.e., before 4:00:01 p.m. Eastern Time) are reported by 8:00:00 a.m. Eastern Time on the following calendar day.

¹⁶ This provision was initially intended to address circumstances where complete information is not available at the time an order report must be submitted (for example, where an order is executed over the course of multiple days, and the total execution information is not available on the same day the order is received). See Securities Exchange Act Release No. 38990 (August 28, 1997), 62 FR 47096 (September 5, 1997). The provision was amended in 2006 to also address circumstances where a firm has traded a security that has not been assigned a symbol and can report the information only after a symbol has been requested, which must be done promptly, and assigned. See Securities Exchange Act Release No. 54585 (October 10, 2006), 71 FR 61112 (October 17, 2006); Notice to Members 06-70 (December 2006).

¹⁷ 15 U.S.C. 78o-3(b)(6).

surveillance systems by providing customer instruction information relating to limit orders and significantly reducing the incidence of “false positive” results caused by identifying permitted trading activity in automated surveillance patterns. By reducing “false positive” results, FINRA can focus its resources on trading activity that has properly been identified as warranting further regulatory scrutiny, thus promoting just and equitable principles of trade and protecting investors and the public interest. FINRA also believes that codifying the time by which OATS reports must be submitted will promote just and equitable principles of trade by ensuring that all members are aware of their reporting obligations.

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.

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

Written comments were neither solicited nor received.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be 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-2011-063 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2011-063. 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; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2011-063 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

Elizabeth M. Murphy

Secretary

¹⁸

17 CFR 200.30-3(a)(12).