Regulatory Notice 14-48

November 2014

Equity Trading Initiatives: OTC Equity Trading Volume

FINRA Requests Comment on a Proposal to Publish OTC Equity Volume Executed Outside Alternative Trading Systems

Comment Period Expires: Friday, January 9, 2015

Notice Type

- Request for Comment

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management
- Systems
- Trading

Key Topics

- Alternative Display Facility
- NMS Securities
- OTC Equity Securities
- OTC Reporting Facility
- Trade Reporting
- Trade Reporting Facilities

Referenced Rules & Notices

- FINRA Rule 4552
- FINRA Rule 4553
- FINRA Rule 6282
- FINRA Rule 6380A
- FINRA Rule 6380B
- FINRA Rule 6622

Executive Summary

FINRA requests comment on a proposal to expand FINRA's alternative trading system (ATS) transparency initiative to publish the remaining equity volume executed over-the-counter (OTC), including non-ATS electronic trading systems and internalized trades. FINRA believes that the public will be able to better understand a firm's trading of equities off exchanges by reviewing the firm's new OTC equity trading volume information together with its existing ATS volume reports.

The proposed rule text is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- Dave Chapman, Director, Market Regulation, at (240) 386-4995;
- Brendan Loonam, Director, Business Services, at (212) 858-4203; or
- Lisa Horrigan, Associate General Counsel, Office of General Counsel, at (202) 728-8190.

FINRA

Financial Industry Regulatory Authority

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by Friday, January 9, 2015.

Comments must be submitted through one of the following methods:

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

  Marcia E. Asquith
  Office of the Corporate Secretary
  FINRA
  1735 K Street, NW
  Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA website. Generally, FINRA will post comments as they are received.[1]

Before becoming effective, the proposed rule change must be filed with the Securities and Exchange Commission (SEC) pursuant to Section 19(b) of the SEA.[2]

Background & Discussion

The proposal set forth in this *Notice* is one of seven FINRA initiatives relating to equity market structure and automated trading activities including high frequency trading (HFT).[3] These initiatives are designed to increase the scope of trading information FINRA receives, provide more transparency into trading activities to market participants and investors and require firms engaged in electronic trading and their employees to be trained, educated and accountable for their role in equity trading.

Under FINRA rules, each ATS is required to report its weekly volume, by security, to FINRA, and as of February 2, 2015, each ATS must use a unique market participant identifier (MPID) for reporting order and trade information to FINRA. As part of these requirements, FINRA makes the reported volume and trade count information for equity securities publicly available on its website.[4] Pursuant to the proposal, FINRA is considering expanding this transparency initiative by publishing the remaining equity trading volume executed OTC by each firm on a security-by-security basis. The proposal would provide additional transparency into a significant portion of the OTC market[5] by enabling market participants and investors to get a better understanding of each firm's OTC trading.

FINRA would derive a firm's non-ATS volume information directly from OTC trades reported to FINRA's equity trade reporting facilities (*i.e.*, the Alternative Display Facility, a Trade Reporting Facility or the OTC Reporting Facility). As such, firms would not have any new or additional reporting requirements as a result of the proposal. A firm's non-ATS volume would be based on trades reported for dissemination purposes—or "tape reports"—on which the firm is identified as the member firm with the trade reporting obligation—or "Executing Party."[6] A firm's published trading volume information would not include trades for which the firm is the reported contra party,[7] nor would it include trades that are reported for regulatory or clearing purposes only—or "non-tape reports." Volume information for each equity security would be published on the FINRA website on a two-week or four-week delayed basis in accordance with the time frames specified for ATS volume publication.[8]

As noted above, FINRA would publish non-ATS trading volume information at the firm level and not on an MPID-by-MPID basis. FINRA believes that this is appropriate because, outside of the ATS context, not all firms have a separate MPID for each unique trading center at the firm, and as such, publishing volume information at the MPID level may not provide meaningful or consistent information to the marketplace. For firms that use more than one MPID for their non-ATS trading,[9] FINRA would aggregate and publish the non-ATS trading volume for all non-ATS MPIDs belonging to the firm under a single "parent" identifier or firm name.[10]

FINRA does not believe that publishing volume information for each firm that executed only a small number of trades or shares in any given period would provide meaningful information to the marketplace. Accordingly, FINRA would combine volume from all firms that do not meet a specified minimum threshold and publish such *de minimis* volume information for those firms on an aggregated basis. For example, if five firms each execute 10 trades in the reporting period in a security, their 50 trades would be aggregated and published as a single line item; the firms and their volume information would not be identified separately. For a firm with more than one non-ATS MPID, the total volume across all of its non-ATS MPIDs would be combined for purposes of determining whether the *de minimis* threshold has been met. FINRA notes that all of the OTC volume would be published, but for firms that meet the *de minimis* threshold, their volume would not be attributed by name.

FINRA is proposing to establish a threshold of fewer than on average 200 non-ATS transactions per day executed by the firm in the security during the one-week reporting period. This proposed threshold is based on the level of trading activity used by the SEC to identify "small market makers" for purposes of exemptive relief from the rule requiring market centers that trade NMS securities to make publicly available electronic reports that include uniform statistical measures of execution quality (SEC Rule 605 of Regulation NMS).[11] FINRA reviewed volume statistics for firms across all securities for a one-week period (June 23 – 29, 2014). This review indicates that without applying any threshold, approximately 300 individual firms would have volume attributed by name. Looking at market participants with on average 200 or more trades per day across all securities, approximately 60 firms—which account for over 98 percent of all trading volume—would have volume attributed by name.

Thus, under the proposal, if a firm averages below 200 (non-ATS) transactions per day across all securities during the reporting period, FINRA would aggregate the firm's volume with that of similarly situated firms. Additionally, because the published volume data would be broken down by security, if a firm averages below 200 (non-ATS) transactions per day in a given security during the reporting period, FINRA would aggregate the firm's volume in that security with that of similarly situated firms, even if the firm averages more than 200 (non-ATS) transactions per day across all securities during the reporting period. For example, if, during the reporting period, Firm 1 averages 10,000 trades per day across all securities, but averages only 50 trades per day in ABCD security, Firm 1's volume in ABCD security would be aggregated with other firms' volume in ABCD for that period.

FINRA seeks comment on the appropriate *de minimis* threshold, and to help inform comments, presents volume statistics at alternative thresholds for the one-week period cited above:

Threshold	Approximate number of market participants that would be identified by name	Percentage of all trading volume attributed to these market participants
On average **300** or more trades per day across all securities	54	98.78%
On average **200** or more trades per day across all securities	62	98.99%
On average **100** or more trades per day across all securities	77	99.30%
On average **50** or more trades per day across all securities	93	99.51%

FINRA considered whether dividing published volume information into more granular categories, such as by trading capacity (*i.e.*, principal versus agency or riskless principal) or by participant type (*e.g.*, market maker), would be feasible or provide additional meaningful or reliable information to market participants. However, FINRA believes that publishing non-ATS trading volume information at more granular levels may increase the potential impact on firms and may raise concerns about potential information leakage, such as the possibility that a firm's trading activity or strategy could be discerned from the data. Further segregating the data, *e.g.*, by trading desk, would entail potentially significant development work by firms to sufficiently identify the activity for FINRA (*e.g.*, volume attributable to a market making desk) and may not be consistent across firms, while also leading to some of the same concerns about information leakage. Thus, FINRA currently is not proposing to publish the non-ATS volume data at more granular levels than by firm and security. FINRA believes that this approach, coupled with the delayed publication of data, should address any concerns a firm may have regarding potential information leakage.

Economic Impacts

Anticipated Benefits

As discussed above, the proposal would expand the benefits of FINRA's ATS transparency program by providing additional transparency on the remaining equity volume executed OTC. The increased transparency would enable market participants and investors to better understand a firm's trading of equities off exchanges, thereby enhancing their understanding of executing firms' trading volume and market shares in the equity market.

Anticipated Costs

The proposal would not impose any additional reporting requirements on firms, and as a result, would have minimal impact on firms from a systems development perspective. FINRA, however, will incur costs for standardizing and compiling the data, development, testing, quality control, business support, and storage and maintenance of the data. While FINRA currently publishes ATS volume data on its website, the proposal would impose additional costs for Web page development and software changes to present the information as proposed, *e.g.*, for purposes of the *de minimis* threshold and aggregation of volume executed by a single market participant's multiple MPIDs.

For fee purposes, this data may be combined with the ATS data that is currently available and for which subscribers are charged under Rule 4553.

Request for Comment

FINRA seeks comments on the proposal outlined above. In addition to general comments, FINRA specifically requests comment on the following questions:

- Would the proposal provide valuable information to the marketplace?
  - How might firms and other market participants use the published non-ATS OTC volume data?
  - Is your firm likely to use this data?
- What (if any) concerns do firms have about publication of their non-ATS OTC volume data?
  - Are there potential competitive disadvantages to attributing non-ATS volume information by firm name?
  - Does limiting the granularity of information and publishing it on a two-week or four-week delayed basis mitigate any concerns firms might have about publication of their volume information? Are there other alternative steps FINRA could take to mitigate those concerns, while still disseminating meaningful information to the marketplace?
- Does the proposal to publish data on a two-week or four-week delayed basis lessen or otherwise change the value of the information?
  - Would data published on a real-time or next-day basis be more useful or provide additional value, and if so, in what way?
  - As discussed above, FINRA is proposing to publish non-ATS volume information on the same delayed basis on which ATS volume data is currently published. Should FINRA consider a different schedule? If so, what alternative schedule do commenters suggest and why?
- Do commenters agree with FINRA's proposal to publish non-ATS volume information at the firm level rather than at the MPID level?
  - If commenters recommend publishing at the MPID level, what additional value would that provide? Would there be ways to increase the consistency and reliability of information at the MPID level?
- Should FINRA consider publishing volume information for non-ATS trading at more granular levels, and if so, what levels (*e.g.*, by capacity)? What would be the costs and benefits of such an approach?

- Do commenters agree with the proposal to aggregate volume information for firms with a *de minimis* amount of trading in any given period?
  - Is the proposed threshold for purposes of publishing aggregated non-ATS trading volume information (*i.e.*, on average 200 trades per day) appropriate? If not, what alternative threshold should FINRA consider and why?
  - Should FINRA consider a separate threshold for less frequently traded securities (*e.g.*, a lower threshold for securities that are not in Tier 1 of the NMS Plan to Address Extraordinary Market Volatility)? If so, what separate threshold do commenters suggest and why?
  - Would a threshold based on share or dollar volume rather than number of trades be more appropriate? Are there other alternative metrics that FINRA should consider in setting the threshold?
- What other economic impacts, including costs and benefits, might be associated with this proposal? Who might be affected and how?

FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible.

Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See NTM 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.

2. *See* Section 19 of the Securities Exchange Act of 1934 (SEA) and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.

3. *See* FINRA September 19, 2014, News Release "FINRA Board Approves Series of Equity Trading and Fixed Income Rulemaking Items".

4. ATS volume information regarding fixed income securities currently is not being disseminated.

5. For example, for the period from May 12 through June 23, 2014, approximately 57 percent of the share volume of OTC trades in NMS stocks was executed outside an ATS.

   FINRA notes that its purview extends only to OTC data, and as such, this proposal does not apply to publication of data relating to trades executed on an exchange.

6. Under FINRA rules, in a trade between a member and non-member or customer, the member has the obligation to report the trade, and in a trade between two members, the "Executing Party," 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, has the obligation to report the trade. *See* Rules 6282, 6380A, 6380B and 6622.

7. FINRA is proposing to include only volume from the executing party perspective because otherwise, published OTC volume would be inflated (*i.e.*, publishing volume from both the executing party and contra party perspectives would double count the executed volume).

8. Under Rule 4552, ATS volume information is published on a two-week delayed basis for NMS stocks in Tier 1 under the NMS Plan to Address Extraordinary Market Volatility (also referred to as the Limit Up/Limit Down Plan) and a four-week delayed basis for all other NMS stocks and OTC equity securities.

9. For example, a firm may use separate MPIDs for its proprietary and agency desks.

10. FINRA reiterates that a firm's ATS volume will continue to be published separately under the unique MPID(s) for each ATS operated by the firm.

11. Specifically, the SEC exempted any market center that reported fewer than 200 transactions per trading day on average over the preceding six month period in securities that are covered by the rule. *See* letter from Annette L. Nazareth, Director, Division, to Richard Romano, Chair, and Carl P. Sherr, Vice-Chair, NASD Small Firms Advisory Board, dated June 22, 2001.

ATTACHMENT A

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

6000. QUOTATION AND TRANSACTION REPORTING FACILITIES

6100. QUOTING AND TRADING IN NMS STOCKS

6110. Trading Otherwise than on an Exchange

(a) Members are required to report transactions in NMS stocks, as defined in Rule 600(b)(47) of SEC Regulation NMS, effected otherwise than on or through a national securities exchange to FINRA. For purposes of the Rule 6100 Series, "otherwise than on an exchange" means a trade effected by a FINRA member otherwise than on or through a national securities exchange. The determination of what constitutes a trade "on or through" a particular national securities exchange shall be determined by that exchange in accordance with all applicable statutes, rules and regulations, and with any necessary SEC approval.

(b) Trading Information for OTC Transactions Executed Outside of Alternative Trading Systems

(1) FINRA will publish on its public web site the Trading Information for NMS stocks for each member with the trade reporting obligation under Rules 6282(b), 6380A(b) and 6380B(b) on the following timeframes:

(A) no earlier than two weeks following the end of the Trading Information week, Trading Information regarding NMS stocks in Tier 1 of the NMS Plan to Address Extraordinary Market Volatility; and

(B) no earlier than four weeks following the end of the Trading Information week, Trading Information regarding NMS stocks that are subject to FINRA trade reporting requirements and are not in Tier 1 of the NMS Plan to Address Extraordinary Market Volatility.

(2) Published Trading Information will be presented on FINRA's web site as follows:

(A) Trading Information will be aggregated for all Market Participant Identifiers (MPIDs) used by a single member (excluding, if applicable, any MPIDs used by the member for reporting trades executed in its alternative trading system).

(B) Trading Information shall be aggregated for members that have executed on average fewer than 200 transactions per day in the NMS stock during the Trading Information week.

(3) "Trading Information" includes:

(A) the number of shares of each NMS stock executed by the member with the trade reporting obligation under Rules 6282(b), 6380A(b) and 6380B(b) and reported to FINRA; and

(B) the number of trades in a security executed by the member with the trade reporting obligation under Rules 6282(b), 6380A(b) and 6380B(b) and reported to FINRA.

"Trading Information" for purposes of this Rule shall not include any transactions executed within an alternative trading system, which information is published under Rule 4552.

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6600. OTC REPORTING FACILITY

6610. General

(a) Members are required to report transactions (other than transactions executed on or through an exchange) in OTC Equity Securities, including secondary market transactions in non-exchange-listed Direct Participation Program securities, and Restricted Equity Securities to the OTC Reporting Facility in compliance with the Rule 6600 and 7300 Series, as well as all other applicable rules and regulations.

(b) Trading Information for OTC Transactions Executed Outside of Alternative Trading Systems

(1) FINRA will publish on its public web site the Trading Information for OTC Equity Securities for each member with the trade reporting obligation under Rule 6622(b) no earlier than four weeks following the end of the Trading Information week.

(2) Published Trading Information will be presented on FINRA's web site as follows:

(A) Trading Information will be aggregated for all Market Participant Identifiers (MPIDs) used by a single member (excluding, if applicable, any MPIDs used by the member for reporting trades executed in its alternative trading system).

(B) Trading Information shall be aggregated for members that have executed on average fewer than 200 transactions per day in the OTC Equity Security during the Trading Information week.

(3) "Trading Information" includes:

(A) the number of shares of each OTC Equity Security executed by the member with the trade reporting obligation under Rule 6622(b) and reported to FINRA; and

(B) the number of trades in a security executed by the member with the trade reporting obligation under Rule 6622(b) and reported to FINRA.

"Trading Information" for purposes of this Rule shall not include any transactions executed within an alternative trading system, which information is published under Rule 4552.

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