



8011-01p
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72191; File No. SR-FINRA-2014-024)

May 20, 2014

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to the Definition of “Reporting Member” in 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 May 12, 2014, 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 and II 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 FINRA Rule 7410 to permit members to route orders to two Reporting Members for a defined period of time provided certain conditions are met without losing the exception from the definition of “Reporting Member” in the Order Audit Trail System (“OATS”) rules.

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

* * * * *

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

* * * * *

7400. ORDER AUDIT TRAIL SYSTEM

7410. Definitions

(a) through (n) No Change.

(o) “Reporting Member” shall mean a member that receives or originates an order and has an obligation to record and report information under Rules 7440 and 7450.

(1) A member shall not be considered a Reporting Member in connection with an order, if the following conditions are met:

(A) the member engages in a non-discretionary order routing process, pursuant to which it immediately routes, by electronic or other means, all of its orders to:

(i) a single receiving Reporting Member; or

(ii) two receiving Reporting Members, provided:

(a) orders are routed by the member to each receiving Reporting Member on a pre-determined schedule approved by FINRA;
and

(b) orders are routed to two receiving Reporting Members pursuant to the schedule for a time period not to exceed one year; and

(B) the member does not direct and does not maintain control over subsequent routing or execution by the receiving Reporting Member(s);

(C) the receiving Reporting Member(s) record(s) and report(s) all information required under Rules 7440 and 7450 with respect to the order; and

(D) the member has a written agreement with the receiving Reporting Member(s) specifying the respective functions and responsibilities of each party to effect full compliance with the requirements of Rules 7440 and 7450.

(2) No Change.

* * * * *

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 Rules 7410 through 7470 (the "OATS Rules") impose obligations on FINRA members to record in electronic form and report to FINRA on a daily basis certain information with respect to orders originated, received, transmitted, modified, canceled, or executed by members relating to OTC equity securities and NMS stocks. OATS captures this order information and integrates it with quote and transaction information to create a time-sequenced record of orders, quotes, and transactions. This information is then used by FINRA staff to conduct surveillance and investigations of member firms for potential violations of FINRA rules and federal securities laws.

In general, the OATS Rules apply to any FINRA member that is a “Reporting Member,” which is defined in Rule 7410 as “a member that receives or originates an order and has an obligation to record and report information under Rules 7440 and 7450.”³ Under Rule 7410, a member is not considered a Reporting Member in connection with an order if the following four criteria are met:

- The member engages in a non-discretionary order routing process, pursuant to which it immediately routes, by electronic or other means, all of its orders to a single receiving Reporting Member;
- The member does not direct and does not maintain control over subsequent routing or execution by the receiving Reporting Member;
- The receiving Reporting Member records and reports all information required under Rules 7440 and 7450 with respect to the order; and
- The member has a written agreement with the receiving Reporting Member specifying the respective functions and responsibilities of each party to effect full compliance with the requirements of Rules 7440 and 7450.⁴

One of the current criteria that must be met for a member to take advantage of the exception from the definition of Reporting Member is that the member immediately route orders on a non-discretionary basis to a single receiving Reporting Member. Thus, members will not be excepted from the definition if they route orders to more than one receiving firm. This exception is generally, though not exclusively, relied upon by introducing firms that route all of their orders

³ Rule 7410(o).

⁴ Rule 7410(o)(1). Rule 7410 also includes an exception from Reporting Member for certain firms who waived into FINRA membership pursuant to NASD IM-1013-1 or NASD IM-1013-2. See Rule 7410(o)(2).

to a single clearing firm that reports the introducing firms' orders on their behalf. As FINRA noted when it adopted the exception, it is intended largely to avoid duplicative reporting of the same order information by two different firms and to avoid imposing unnecessary compliance costs and burdens on firms that route all of their orders immediately to another single firm that reports the information to OATS.⁵

The proposed rule change would permit a member to continue to rely on the exception from the definition of Reporting Member if, for a limited time, the member routes orders to two different Reporting Members, provided certain criteria are met. Although not limited to this purpose, the proposed rule change is intended to accommodate introducing firms that transition to a different clearing firm over time and, during the transition, route their orders to two different clearing firms, both of which report the introducing firm's order information to OATS during the transition period. Without the proposed rule change, introducing firms would be subject to the OATS Rules during the transition period, which is generally less than one year. FINRA believes it is unnecessarily burdensome to require introducing firms to report order information directly to OATS under these circumstances when the transition period is less than one year. FINRA notes that the concern over duplicative reporting is similarly present in the case where all of a firm's order information is being reported by another Reporting Member even if, for a limited period of time, order information is reported by two separate Reporting Members. Further, FINRA believes it would be burdensome for a member that meets the exception to Reporting Member to have to commence OATS reporting for a limited period, to only later meet the terms of the exception again.

⁵ See Securities Exchange Act Release No. 52521 (September 28, 2005), 70 FR 57909 (October 4, 2005) (Order Approving SR-NASD-2000-23).

Under the proposed rule change, a member would remain excepted from the definition of Reporting Member during a transition period to a new clearing firm when it routes to both its former and new clearing firm provided certain additional criteria are met in addition to the existing criteria necessary to meet the exception. Specifically, under the terms of the proposed rule change: (i) All orders must be routed by the member to each receiving Reporting Member on a pre-determined schedule approved by FINRA; and (ii) the orders may only be routed to two receiving Reporting Members pursuant to the schedule for a time period not to exceed one year. In addition to these additional criteria, members must continue to meet the existing criteria in the rule.

Under the proposed rule change, FINRA must be notified in advance and must approve the schedule for the transition to a new clearing firm.⁶ The time period for the transition set out in the schedule may not exceed one year. This requirement is necessary to ensure that FINRA staff is aware of the transition schedule and can ensure that surveillance using OATS data is conducted correctly and that order information is properly identified. In addition, FINRA believes that the ability to rely on the exception should be limited to transition periods of one year or less. FINRA believes that members otherwise excepted from the definition of Reporting Member should not be required to incur the costs associated with OATS reporting for standard transitions between clearing firms; however, FINRA does not believe it is appropriate to permit members to take advantage of the exception and avoid directly reporting to OATS for lengthy periods of time (i.e., in excess of one year) where they route orders to multiple firms.

⁶ FINRA anticipates that firms would notify FINRA by contacting OATS Operations staff by telephone and then supplying FINRA with a copy of the transition schedule prepared by the firm.

FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing so FINRA can implement the proposed rule change immediately.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁷ 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 permitting members that are excepted from the definition of “Reporting Member” to continue to rely on the exception during a transition to another clearing firm will avoid duplicative order information being reported to OATS and will avoid the imposition of unnecessary compliance costs on introducing firms.

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. FINRA believes the proposed rule change will reduce the potential burden of reporting to OATS for a limited time for a member that does not meet the current exception to Reporting Member only to later meet the terms of the exception again. FINRA believes that, in the limited circumstances in which the proposed rule change will apply, members should not be compelled to undertake the time and costs associated with OATS reporting when FINRA is able to ensure

⁷ 15 U.S.C. 78o-3(b)(6).

the accuracy and completeness of OATS information when the terms in the proposed rule change are met.

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

Because the foregoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act⁸ and Rule 19b-4(f)(6) thereunder.⁹

FINRA has asked the Commission to waive the 30-day operative delay so that the proposal may become operative upon filing. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest as it will allow members that currently rely on the exception from being considered a Reporting Member to continue to do so for a limited period of time while they change clearing firms, provided the criteria in the proposed rule change are met, thus eliminating the burden of reporting directly to

⁸ 15 U.S.C. 78s(b)(3)(A).

⁹ 17 CFR 240.19b-4(f)(6). As required under Rule 19b-4(f)(6)(iii), FINRA provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and the text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

OATS for such members and maintaining the integrity of the OATS data. For this reason, the Commission designates the proposed rule change to be operative upon filing.¹⁰

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or 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-2014-024 on the subject line.

Paper Comments:

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

¹⁰ For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

All submissions should refer to File Number SR-FINRA-2014-024. 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-2014-024 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.¹¹

Kevin M. O'Neill,
Deputy Secretary.

¹¹ 17 CFR 200.30-3(a)(12).

[FR Doc. 2014-12070 Filed 05/23/2014 at 8:45 am; Publication Date: 05/27/2014]