



SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-73762; File No. SR-FINRA-2014-050)

December 5, 2014

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend TRACE Rules to Require Members to Identify Transactions with Non-Member Affiliates and to Change How FINRA Disseminates a Subset of Such Transactions

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 November 21, 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, 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 the FINRA Rule 6700 Series (Trade Reporting and Compliance Engine (TRACE)) to require members to identify transactions with non-member affiliates, and to change how FINRA disseminates a specific subset of these transactions.

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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 amending the TRACE rules: (1) to add a new contra-party type to be used in TRACE reports to identify transactions with non-member affiliates, and (2) to require firms to identify when transactions with non-member affiliates meet specified conditions, so that FINRA can suppress dissemination of those trades.

FINRA Rule 6730 (Transaction Reporting) sets forth the requirements applicable to members for reporting transactions in TRACE-Eligible Securities.³ Rule 6730(c) (Transaction Information To Be Reported) describes the items of information that must be included in a TRACE trade report. Among other things, members must identify the other side (i.e., contra-party or counterparty) for each transaction.⁴ Where the contra-party is a FINRA member, the reporting member must provide the contra-party's designated Market Participant ID ("MPID") in

³ Rule 6710 generally defines a "TRACE-Eligible Security" as: (1) a debt security that is U.S. dollar-denominated and issued by a U.S. or foreign private issuer (and, if a "restricted security" as defined in Securities Act Rule 144(a)(3), sold pursuant to Securities Act Rule 144A); or (2) a debt security that is U.S. dollar-denominated and issued or guaranteed by an "Agency" as defined in Rule 6710(k) or a "Government-Sponsored Enterprise" as defined in Rule 6710(n).

⁴ FINRA Rule 6730(c)(6) provides that each TRACE trade report shall contain the contra-party's identifier.

the trade report. All other contra-parties (including non-member affiliates) can only be identified as a “customer” when reporting the transaction to TRACE.

FINRA is proposing to amend Rule 6730 to introduce a new contra-party type to identify non-member affiliates of the member reporting the trade, and to disseminate publicly this contra-party identifier.⁵ Currently, as noted above, when a member engages in a transaction with a non-member affiliate, that transaction is reported by the member as a trade with a customer. Thus, the proposal would provide FINRA and market participants with additional identifying information regarding the contra-party in the case of member trades with non-member-affiliates.⁶

FINRA also proposes to require members to identify a narrow subset of transactions with non-member affiliates. Specifically, a member would need to flag transactions between itself and a non-member affiliate: (1) where both parties are trading for their own account, and (2) where the transaction with the non-member affiliate occurs within the same day, at the same price and in the same security as a transaction engaged in by the member with a different counterparty. Identification of these transactions by members would enable FINRA to suppress the transactions from dissemination on the tape, which is desirable because they are not

⁵ The proposed rule change would add a new definition to Rule 6710 to define “non-member affiliate” as a non-member entity that controls, is controlled by or is under common control with a member. For the purposes of this definition, “control,” along with any derivative thereof, means legal, beneficial, or equitable ownership, directly or indirectly, of 25 percent or more of the capital stock (or other ownership interest, if not a corporation) of any entity ordinarily having voting rights. The term “common control” means the same natural person or entity controls two or more entities.

⁶ The proposal would not change the way that FINRA members report trades with affiliates that also are FINRA members; the reporting member would continue to identify the contra-party by MPID. FINRA believes that trades between members generally are arms-length, even if the member firms are affiliated. Furthermore, it is important for audit trail and surveillance purposes to obtain the MPID of all member contra-parties in submitted trade reports.

economically distinct transactions and provide the same pricing information as the disseminated transaction between the member and the other contra-party to the trade.

The undesirability of disseminating these trades is illustrated by the following example. Firm A, a FINRA member, acquires a position in a TRACE-Eligible Security from another dealer, which Firm A reports for dissemination by TRACE. Firm A may choose to hold this security at a non-member affiliate, which it accomplishes by a back-to-back trade to the affiliate on the same terms as it acquired the security. Currently, this back-to-back trade with the affiliate would also be reported by the member for dissemination by TRACE. FINRA believes that only one of the trade reports related to this overall transaction should be disseminated – specifically, the transaction between the member and the other dealer, but not the trade between the member and its non-member affiliate. Dissemination of the transaction between the member and its non-member affiliate does not provide users of the disseminated data with useful information for pricing, valuation or risk evaluation purposes.

FINRA would only suppress dissemination where a member purchases or sells a security and then, within the same trading day, engages in a back-to-back trade with its non-member affiliate in the same security at the same price. Because the trade of the security between the member and its non-member affiliate represents a change in beneficial ownership between different legal entities, it is a reportable transaction and is publicly disseminated under the current rule. However, the fact that the trade occurs with a non-member affiliated entity, during the same day and at the same price (no commission or mark-up was assessed) is indicia that the transaction is not an arms-length trade and, therefore, does not constitute the type of transaction that adds value to the tape.

FINRA believes the proposal will improve the information currently received for regulatory purposes by providing additional information on the relationship between parties to a trade. For example, knowledge of a contra-party's status as a non-member affiliate of the reporting member would be useful in FINRA's regulatory program, which is reliant upon the completeness and accuracy of the information members report to TRACE. For example, the proposed rule change would support the operation of the patterns that surveil for pre-arranged trading, best execution, parking and fair pricing. Thus, FINRA expects that the addition of the non-member affiliate contra-party identifier will facilitate a more effective program and reduce the number of false-positive alerts from surveillance patterns and regulatory inquiries from FINRA to member firms. FINRA also believes the rule change will improve the quality of the information disseminated for transparency purposes by suppressing transaction reports that are not economically distinct from a separately reported (and disseminated) leg, and by disseminating a new contra-party identifier in all cases when a trade is with a non-member affiliate.

FINRA staff discussed the proposal with advisory committees in developing its approach. These parties were supportive of the proposal, believing that it would improve the value of the information submitted to the tape by reducing the instances in which duplicative trade information is disseminated publicly. Members of the committees also did not express any particular concerns with respect to the operational impacts or costs of the proposal. Further discussions with firms that would be directly impacted by the proposal also indicated that the proposal to suppress dissemination of these trades would be beneficial to market participants, and that the necessary technological changes would not be unduly burdensome given an adequate implementation timeframe.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be no later than 90 days following publication of the Regulatory Notice announcing 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,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.

As discussed above, FINRA believes the proposal would result in improved disseminated transaction information for TRACE-Eligible Securities by reducing the instances in which trade information for duplicative, non-economic trades is disseminated publicly. Under the proposal, TRACE reports also would include more specific contra-party information by adding an additional contra-party type to identify non-member affiliates that would be used by FINRA for regulatory purposes and disseminated to investors and market participants. Thus, FINRA believes that the proposed rule change would enhance transparency by suppressing trade reports on transactions that are not economically distinct from a separately reported (and disseminated) leg, and the regulatory audit trail by providing additional granularity regarding the reporting firm's relationship with its contra-party.

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. While

⁷ 15 U.S.C. 78o-3(b)(6).

the proposal would require firms to implement changes to identify covered transactions with a non-member affiliate, FINRA does not believe these changes would impose differential costs on similarly situated firms. Discussions with members indicate that, so long as sufficient implementation time is provided to make the necessary technological changes, the proposed rule change would not be unduly burdensome, given its benefits to transparency. In addition to the benefits to public transparency, the non-member affiliate contra-party identifier will facilitate a more effective regulatory program by allowing FINRA further insight into whether a member's transaction is arms-length. In addition, FINRA anticipates the proposal would result in a reduction in the number of false-positive alerts from surveillance patterns and fewer regulatory inquiries from FINRA to member firms.

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

FINRA has not solicited, and does not intend to solicit, comments on this proposed rule change. FINRA has not received any written comments from members or other interested parties.

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-2014-050 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-FINRA-2014-050. 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 10:00 a.m. and 3:00 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-2014-050 and should be submitted on or before [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁸

Brent J. Fields,
Secretary.

8011-01p

[FR Doc. 2014-29013 Filed 12/10/2014 at 8:45 am; Publication Date: 12/11/2014]

⁸ 17 CFR 200.30-3(a)(12).