



November 16, 2007

Barbara Z. Sweeney
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006

Re: Regulatory Notice 07-46: Proposed Amendments to OTC Trade Reporting Requirements for Equity Securities

Dear Ms. Sweeney:

The Securities Industry and Financial Markets Association¹ (“SIFMA”) appreciates the opportunity to comment on the Financial Industry Regulatory Authority’s (“FINRA”) proposed amendments to over-the-counter (“OTC”) trade reporting requirements for equity securities. There have been a number of significant changes in the securities markets over the past several years, particularly with the recent implementation of Regulation NMS, and SIFMA commends FINRA for its willingness to consider potential modifications of its trade reporting rules in light of these changes.

Trade Reporting Structure Proposal

Current NASD Rules require that: (i) in transactions between two market makers, the sell-side market maker reports the trade; (ii) in transactions between a market maker and non-market maker, the market maker reports the trade; (iii) the sell-side reports transactions involving two non-market makers; and (iv) the member firm reports transactions between a member firm and either a non-member or a customer.² As FINRA points out in its request for comment, the

¹ The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA’s mission is to promote policies and practices to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public’s trust and confidence in the markets and the industry. SIFMA works to represent its members’ interests locally and globally. It has offices in New York, Washington, D.C., and London, and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. (More information about SIFMA is available at: www.sifma.org.)

² See NASD Rules 4632(b), 4632A(b), 4632C(b), 4632E(b), and 6620(b).

current trade reporting structure, in which reporting responsibility hinges on whether and how market makers are involved in transactions, can result in confusion about who has reporting responsibility, delays in reporting trades, and the double-reporting of trades.³ In addition, the responsibility of trading centers to comply with the requirements of Rule 611 under Regulation NMS, including determining whether a trade may be executed within an exception or exemption from the rule, adds a layer of complexity to the current trade reporting structure. NASD trade reporting rules require member firms submitting trades to include appropriate modifiers with respect to trades executed pursuant to certain exceptions or exemptions from Rule 611.⁴ However, in a transaction where the firm responsible for trade reporting is not also the executing broker, the trade reporting firm may not know whether the executing broker relied upon an exception or exemption from Rule 611, may not be able to easily obtain such information, and, in any event, will not be able to verify such information independently. Such situations inhibit the accurate reporting of trades with appropriate Rule 611 modifiers and may increase the appearance of trade-throughs on the Consolidated Tape when, in fact, there may be no trade-through violation due to a valid exception or exemption from Rule 611.

Therefore, firms in general believe that the most effective way to facilitate the appropriate marking of trade reports is to require the executing broker to report transactions where the executing broker is defined as the broker that receives the order (*e.g.*, the broker receiving the initial contact, whether electronically or by telephone) and does not subsequently reroute the order.⁵ The executing broker knows all of the essential terms of the transaction, as well as whether and which exceptions or exemptions from Rule 611 apply to the transaction. As a result, the executing broker is in the position best able to append the necessary trade modifier(s) and report the transaction. An added advantage of moving to a different trade reporting structure is that firms no longer will need to engage in the cumbersome process of monitoring market maker lists and continuously updating their systems to reflect changes in market maker status. We note that the alternatively proposed sell-side reporting structure, while simpler than the current trade reporting rules, will not resolve the Rule 611 concerns mentioned above where the selling/reporting broker-dealer is not the executing broker-dealer for the trade.

³ FINRA Regulatory Notice 07-46, OTC Trade Reporting, 5 (Sept. 2007) (“OTC Proposal”).

⁴ NASD Rule 4632C(a)(5)(C); *see also*, FINRA Notice to Members 07-23, NASD Trade Reporting Requirements Related to Regulation NMS (May 2007).

⁵ We note that one firm has suggested that defining the executing broker as the broker-dealer who would file the execution report (*i.e.*, the person who receives the order and does not subsequently reroute) under OATS currently would provide a familiar structure to firms and FINRA alike. The firm suggested that this also would resolve concerns about how to manage manual orders, because this problem has been addressed in the OATS arena. Another firm has suggested defining the executing broker as the broker-dealer that determines the ultimate price of the trade and the time of execution. We are happy to work with FINRA to further refine the executing broker definition as needed to create an effective trade reporting structure.

SIFMA understands that changing to an executing broker reporting structure may not resolve all trade reporting problems. For instance, there may be certain manually negotiated transactions (*e.g.*, where two member firms negotiate a transaction over the telephone) where it becomes difficult to identify the executing broker for the transaction for trade reporting responsibility purposes. We believe the above definition of executing broker should resolve this issue for most manually negotiated trades. Also, as markets increasingly automate, we believe that these transactions make up a decreasing number of overall trade reports. In any event, an executing broker trade reporting structure will have significant benefits even if applied only to electronic orders. If FINRA has concerns about defining the executing broker for such trades, or if it should prove necessary in connection with a particular manually negotiated trade, FINRA could require firms to confirm which party is the executing broker and is therefore responsible for executing and reporting the transaction in these situations.

Linking Proposal

FINRA also has proposed that firms provide information to link related trade reports when both a tape and a non-tape report are submitted to FINRA for the same overall transaction.⁶ Currently, firms are not required to provide specific information on tape and non-tape reports concerning such a transaction (*e.g.*, riskless principal transactions) that indicate they are related to each other. Instead, firms retain this information internally and make it available during inspections or examinations.

As a preliminary matter, SIFMA believes FINRA and the other self-regulatory organizations (“SROs”) should coordinate their efforts to update and revise their trade reporting requirements and structures. Increased automation in the securities markets as well as the implementation of Regulation NMS have led to a dramatic increase in quote traffic and heavy demands on firms’ trade data handling and storage systems, and these demands are exacerbated by increasingly complex and oftentimes duplicative trade reporting requirements. SIFMA would like to work with FINRA and other SROs toward simplifying and streamlining the trade reporting process. We currently are forming an ad hoc committee to address these issues on an industry-wide level, with a view towards moving toward a more uniform approach, if not a single reporting system. A more uniform approach by regulators with respect to trade reporting information will reduce redundancies and inconsistencies, provide appropriate and necessary trade information to regulators, and reduce the time and resources required from firms.

SIFMA is concerned that FINRA’s proposed linking of the tape and non-tape legs of riskless principal trades, in light of the NYSE’s recent Rule 92 amendments to its Front End Systematic Capture (“FESC”) system concerning riskless principal trade reporting, raises some of the concerns noted above. Firms are concerned that these new reporting requirements, compounded by the differences between FESC and FINRA’s proposed linking rules, will demand a great deal of time and resources from firms in reprogramming their systems to accommodate these new regulatory requirements.

⁶ OTC Proposal at 5.

Firms have noted several difficulties in the structuring of a linkage system for riskless principal trades. One problem is that often firms do not know at the time they are executing an order whether, or how much, of the order ultimately will be deemed executed on a riskless principal basis. This would make it very difficult, if not impossible, for firms to identify a trade as riskless principal in order to append an appropriate identifier or attach a control number on a real-time basis. Firms that accumulate a position through multiple street-side trades and then execute the accumulated position with a customer as riskless principal also will experience difficulty complying with the proposed linking rule; linking these multiple trades to the single trade using either an identifier or a control number process will be cumbersome for firms to implement at best. A similar issue arises when a single street-side transaction in turn is allocated on a riskless principal basis to multiple customers. Finally, it is also difficult to determine how to provide and coordinate the use of linkage information for trades that are not reported to NASDAQ but to other exchanges, or for trades subject to Attachment 2 arrangements where one broker-dealer executes and reports the first leg of a trade while another broker-dealer reports the riskless leg of the trade to NASDAQ.

In light of these problems, SIFMA believes that the implementation of a linkage system may not be the optimal course of action at this time. Until the industry and various SROs can fully assess all of the issues associated with such a system (and, as noted above, we are forming an ad hoc committee to help address this issue), we believe that permitting firms to continue to maintain information with respect to riskless principal transactions internally and to make it available to regulators during examinations would be a more efficient and effective approach in the short term. Therefore, we request that FINRA defer final consideration of the linkage proposal until an industry-wide review of such a system can be conducted. In the meantime, however, SIFMA encourages FINRA to proceed with implementing an executing broker trade reporting structure, as discussed above.

If FINRA is unwilling to defer its linkage proposal, SIFMA asks instead that FINRA work with firms and with the NYSE before finalizing its position to resolve the various implementation issues involved in creating an efficient and workable riskless principal linkage system. Some firms have suggested that such a system could closely track existing OATS reporting processes as part of a larger move toward a more cohesive surveillance structure that takes into account current OATS, OTS, FESC, and other trade reporting rules and procedures. Such an approach would facilitate the future development of a harmonized trade reporting system that would provide necessary trade reporting information to regulators, reduce the time and resource burdens on firms created by multiple, disparate reporting processes, and address current regulatory concerns about limit and market order protection. At a minimum, SIFMA believes that any linkage system should permit the submission of linkage information on an end-of-day, rather than a real-time or intraday, basis in order to mitigate, at least in part, some of the issues raised above.⁷

⁷ At this time, we understand that the NYSE is considering allowing end-of-day submission of linkage information as well as intraday submissions.

As an alternative to an entirely new linkage system, some SIFMA firms suggest that FINRA consider whether the data reported to OATS and/or OTC would be sufficient to link the tape and non-tape trade submissions to provide sufficient information concerning riskless principal trades. Because the primary purpose of OATS is to provide an integrated audit trail of order event information, the linking of tape and non-tape reports appears to fall within the scope of OATS reporting. In addition, it may be that relatively minor changes to the OATS technical specifications would provide FINRA with a reasonable method to link related tape and non-tape trade events, without requiring firms to undertake the more significant systems changes an additional linkage system would require.⁸ We ask FINRA to discuss the feasibility of this approach with firms to determine whether it would be a more efficient and effective means of providing the information FINRA is seeking.

Firms will require sufficient time to reprogram their systems to accommodate a new linkage system, particularly if other systems such as the TRF are affected. In addition, because many, if not most, firms have adopted the “alternative approach” to riskless principal reporting (*i.e.*, submitting orders marked as principal to the tape, and a separate, non-tape, non-clearing report on the second leg of the transaction to the customer), real-time linkage reporting would entail even more extensive changes to existing systems and business practices. We believe that, depending on the proposal approved, approximately nine to twelve months will be necessary from the time that final changes to the TRF reporting systems are implemented for firms to make corresponding changes to their own systems to accommodate the proposal. In addition, SIFMA urges that there be an additional adequate period of industry-wide testing to ensure the linkage system operates effectively.

Conclusion

SIFMA appreciates this opportunity to address the issues raised by FINRA’s proposals, and looks forward to working with FINRA on them. SIFMA believes an executing broker reporting structure, with appropriately modified rules for manually negotiated orders, as necessary, would simplify the trade reporting structure and help address the trade reporting issues that firms currently face as a result of Regulation NMS. Although SIFMA appreciates FINRA’s efforts to improve trade reporting through a linkage system for riskless principal trades, we are concerned that such a step may be premature given firms’ reservations with respect to the current NYSE FESC requirement and the benefits of working toward a more integrated, market-wide trade reporting structure. At a minimum, we believe that the linkage proposal is inadvisable without coordination with the NYSE’s efforts in this regard, and without examining current systems to determine whether relatively minor alterations might provide FINRA with the

⁸ We note that a few firms have expressed reservations about whether modifying OATS would resolve some of the issues raised above concerning a linkage system, and some are concerned that the required changes to OATS would be too extensive and cumbersome to be useful. Overall, SIFMA is happy to work with FINRA to explore whether changes to OATS would be a potential avenue for a linkage system.

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information it is seeking. Therefore, SIFMA urges FINRA to defer consideration of the linkage proposal until such time that industry and SRO representatives can fully assess the most efficient and effective manner in which to implement a linkage system.

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If you have any comments or questions, please do not hesitate to contact me at 202.962.7300.

Sincerely,



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SIFMA

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