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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74482; File No. SR-FINRA-2014-050)

March 11, 2015

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Amended, to Require a Member to Identify Transactions With a Non-Member Affiliate and to Change How FINRA Disseminates a Subset of Such Transactions

I. Introduction

On November 21, 2014, the Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend the FINRA Rule 6700 Series (Trade Reporting and Compliance Engine (TRACE)): (1) to add a new contra-party type to be used in TRACE reports to identify a transaction with a non-member affiliate, and (2) to require a firm to identify when a transaction with a non-member affiliate meets specified conditions, so that FINRA can suppress dissemination of such trade. The proposed rule change was published for comment in the Federal Register on December 11, 2014, and the comment period expired on January 2, 2015.[3] The Commission received two comments on the proposal.[4]

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 73762 (December 5, 2015), 79 FR 73670 (December 11, 2015) ("Notice of Original Proposal").

4 See Letters to the Commission from Sean C. Davy, Managing Director, Securities Industry and Financial Markets Association, dated December 23, 2014 ("SIFMA Letter") and Kyle C. Wooten, Deputy Director – Compliance and Regulatory, Thomson Reuters, dated January 2, 2015 ("Thomson Reuters Letter").

On January 14, 2015, FINRA granted the Commission an extension of time to act on the proposal until March 11, 2015. On February 24, 2015, FINRA filed Amendment No. 1 with the Commission to respond to the comment letters and to propose modifications and clarifications to its proposal.[5] The Commission is publishing this notice and order to solicit comments on Amendment No. 1 and to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

II. Description of the Proposal

FINRA has proposed to amend the TRACE rules 6700 Series: (1) to add a new contra-party type to be used in TRACE reports to identify a transaction with a non-member affiliate, and (2) to require a firm to identify when a transaction with a non-member affiliate meets specified conditions, so that FINRA can suppress dissemination of such trade.

FINRA Rule 6730 (Transaction Reporting) sets forth the requirements applicable to members for reporting transactions in TRACE-Eligible Securities. 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, a member must identify the other side (i.e., contra-party or counterparty) for each transaction.[6] Where the contra-party is a member, the reporting member must provide the contra-party's designated Market Participant ID ("MPID") in the trade report. All other contra-parties (including non-member affiliates) can be identified only as a "customer" when reporting the transaction to TRACE.

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5 See FINRA Response to Comments, dated February 24, 2015 ("FINRA Response Letter"). The FINRA Response Letter is included in the public comment file for SR-FINRA-2014-050.

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

FINRA has proposed to amend Rule 6730 to introduce a new contra-party type to identify a non-member affiliate of the member reporting the trade, and to disseminate publicly this contra-party identifier.[7] Currently, 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.[8] Thus, the proposal would provide FINRA and market participants with additional identifying information regarding the contra-party in the case of a member trade with a non-member affiliate.[9]

FINRA also proposed to require members to identify a narrow subset of transactions with non-member affiliates. Specifically, a member would need to apply a "Suppression Indicator" to a transaction between itself and a non-member affiliate where: (1) each party is trading for its own account, and (2) 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 ("Suppression Criteria"). Identification of these transactions by members would enable FINRA to suppress the transactions from dissemination on the tape, as FINRA believes that these transactions are not economically distinct from the disseminated transaction between the member and the other contra-party to the trade.

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7 The proposed rule change would define "non-member affiliate" in Rule 6710 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.

8 FINRA's Response Letter indicated that a member may conduct a periodic assessment of its affiliate relationships to determine whether a relationship qualifies for non-member affiliate identification requirements. See FINRA Response Letter at 5.

9 The proposal would not change the way that a member reports a trade with an affiliate that also is a member; the reporting member would continue to identify the contra-party by MPID.

FINRA would suppress dissemination only 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.[10] Because the transaction 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.

Implementation Schedule

FINRA stated in the Notice of Original Proposal that it would announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval, and that the implementation date would be no later than 90 days following publication of the Regulatory Notice announcing Commission approval.

In Amendment No. 1, FINRA revised its implementation schedule in response to commenters' concerns. FINRA stated that it would announce the implementation date in a Regulatory Notice to be published no later than 120 days following Commission approval, and the implementation date would be no sooner than 120 days, and no later than 270 days, following publication of the Regulatory Notice.[11]

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[10] In FINRA's Response Letter, it clarified that, when a member and a non-member affiliate enter into a transaction in a TRACE-eligible security and do not initially include the Suppression Indicator, but meet the Suppression Criteria during the day, the member would not be required to correct the trade report to include the Suppression Indicator. However, if the Suppression Indicator is included but ultimately the transaction does not meet the Suppression Criteria, the member must correct the prior trade report and remove the Suppression Indicator. See FINRA Response Letter at 4-5.

[11] See FINRA Response Letter at 5.

III. Summary of Comments, FINRA's Response, and Proposed Modifications and Clarifications in Amendment No. 1

As noted above, the Commission received two comment letters concerning the proposal.[12] Although both commenters were generally supportive of FINRA's goal to improve the quality of information reported to and disseminated by TRACE, one commenter supported the proposed requirement to identify and suppress back-to-back trades done with a non-member affiliate on the same day for the same price and in the same security[13] while the other opposed it.[14]

The supporting comment letter acknowledged that continued dissemination of transactions that meet the Suppression Criteria would be undesirable, but asked that FINRA permit members to check for affiliate status at specific or periodic points in time, because the level of ownership interest in an affiliate is subject to change over time.[15] This commenter requested that FINRA better align and coordinate reporting changes both internally and with the MSRB. Coordination was requested to reduce the burden on updating technology and compliance processes by packaging potential changes together, thereby alleviating multiple changes at different times in the same year.[16] This same commenter requested that FINRA and the MSRB work more closely to coordinate and use similar approaches and methodologies for trade reporting that would lower costs of implementation and maintenance.[17]

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12 See supra note 4.

13 See SIFMA Letter at 1.

14 See Thomson Reuters Letter at 3.

15 See SIFMA Letter at 2.

16 See id.

17 See id.

The other commenter was opposed to the proposal's requirement to identify and suppress back-to-back trades done with a non-member affiliate.[18] This commenter believed that the effort and cost to implement the change would be unduly burdensome.[19]

Both commenters requested an extension in the implementation timeline of four[20] to six[21] months for technological implementation. One commenter requested the additional time to provide sufficient time for implementation and to be less disruptive to the technology budgets, plans, and priorities for 2015.[22] The commenter stated that the proposed timeframe was "too aggressive" and would "add to what already is a collective strain on industry technology and compliance resources and subject matter expertise."[23]

FINRA's Response

In response to these comments concerning the implementation and application of the proposed rule change, FINRA filed Amendment No. 1.[24] FINRA extended the time period for implementation, as described above, and provided guidance on classifying an entity as a non-member affiliate. FINRA also reaffirmed that it would "continue to coordinate with other regulators, where practicable."[25]

In addition, FINRA agreed that there are instances where including the Suppression Indicator would cause operational difficulties. Therefore, FINRA clarified that, when a member

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18 See Thomson Reuters Letter at 3.

19 See id.

20 See SIFMA Letter at 1 (requesting an implementation period of four to five months).

21 See Thomson Reuters Letter at 2 (requesting an implementation period of "not less than six months…").

22 See Thomson Reuters Letter at 2.

23 Id.

24 See supra note 5.

25 FINRA Response Letter at note 7.

and a non-member affiliate enter into a transaction in a TRACE-Eligible Security and do not initially include the Suppression Indicator but meet the Suppression Criteria during the day, the member would not be required to correct the trade report to include the Suppression Indicator.[26] However, if the Suppression Indicator is included but ultimately the transaction does not meet the Suppression Criteria, the member must correct the prior trade report and remove the Suppression Indicator.[27]

FINRA indicated that a member may conduct a periodic assessment of its affiliate relationships to determine whether a relationship qualifies for non-member affiliate identification requirements. The member may conduct a periodic assessment, no less than annually, unless the member has undergone an organizational or operational restructuring that would likely impact its prior identification of non-member affiliate relationships.[28]

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

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26 See FINRA Response Letter at 4-5 (stating that "where a member does not append the non-member affiliate – principal transaction indicator to a trade report reflecting a transaction with a non-member affiliate that ultimately proved to have been the initial leg of a same day, same price trade with another contra-party, the member would not be required to correct the prior trade report solely for the purpose of appending the indicator so long as the member did not reasonably expect (at the time of the initial trade report) to engage in a subsequent same day, same price transaction in the same security with another contra-party").

27 See FINRA Response Letter at 5.

28 See id.

- 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 20549-1090.

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 the filing will also 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 publicly available. All submissions should refer to File Number SR-FINRA-2014-050 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Commission Findings

After carefully considering the proposed rule change, the comments submitted, and FINRA's response to the comments and Amendment No. 1, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.[29] In particular, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with Section 15A(b)(6) of the Act,[30] which requires, among other things, that FINRA rules 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.

The proposal requires a reporting member to include a new "non-member affiliate" identifier in the reports of a transaction in a TRACE-Eligible Security, and to identify a narrow subset of such transactions that meet the Suppression Criteria. FINRA stated that this additional information would facilitate a more effective surveillance program and improve post-trade transparency. The Commission believes that these new requirements are reasonably designed to carry out these objectives and are therefore consistent with the Act. Furthermore, the Commission does not believe that commenters raised any issue that would preclude approval of this proposal, and that FINRA reasonably responded to the comments in Amendment No. 1.

VI. Accelerated Approval

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,[31] for approving the proposed rule change, as modified by Amendment No. 1 thereto, prior to the 30th day after publication of Amendment No. 1 in the Federal Register. Amendment No. 1 responds

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29 In approving this proposed rule change, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

30 15 U.S.C. 78o-3(b)(6).

31 15 U.S.C. 78s(b)(2).

to the specific issue regarding the implementation timeframe raised by both comment letters. Furthermore, Amendment No. 1 clarifies when the Suppression Indicator should be included as well as when to determine non-member affiliate status. The Commission notes that the rest of the proposed rule change is not being amended and was subject to a full notice-and-comment period. These revisions add clarity to the proposal and do not raise any novel regulatory concerns. Accordingly, the Commission finds that good cause exists to approve the proposal, as modified by Amendment No. 1, on an accelerated basis.

VII. Conclusion

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act[32] that the proposed rule change (SR-FINRA-2014-050), as modified by Amendment No. 1, be and hereby is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[33]

Brent J. Fields
Secretary

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32 15 U.S.C. 78s(b)(2).

33 17 CFR 200.30-3(a)(12).