

Regulatory Notice

07-38

Non-Tape (Or Clearing-Only) Reports

FINRA Extends Implementation of Rule Amendments Relating to Non-Tape (Or Clearing-Only) Reports for Previously Executed Trades

Revised Effective Date: November 5, 2007

Executive Summary

FINRA is issuing this *Notice* to extend the effective date of the new trade reporting requirements relating to non-tape (or clearing-only) reports. This *Notice* supersedes *Regulatory Notice 07-33* (August 2007) and replaces the guidance provided in that *Notice*.

As revised, on November 5, 2007, member firms will be prohibited from submitting to a FINRA Facility any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to that FINRA Facility, except where such report is submitted to reflect the offsetting portion of a riskless principal transaction or an agency transaction where a firm acts as agent on behalf of another member firm.

The text of the amended rule language is available at www.finra.org/rulefilings/2007-040.

Questions regarding this *Notice* may be directed to the Legal Section, Market Regulation at (240) 386-5126; or the Office of General Counsel at (202) 728-8071.

August 2007

Notice Type

- Rule Amendment

Suggested Routing

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

Key Topic(s)

- Agency
- Alternative Display Facility
- OTC Reporting Facility
- Riskless Principal
- Step-Outs
- Reversals
- Trade Reporting
- Trade Reporting Facilities

Referenced Rules & Notices

- NASD Rules 6130, 6130A, 6130C, 6130D and 6130E
- NASD Rules 4632, 4632A, 4632C, 4632D and 4632E
- NASD Rule 5000
- Regulatory Notice 07-33
- NTM 05-11
- NTM 98-40

Background & Discussion

On June 22, 2007, FINRA filed with the Securities and Exchange Commission (SEC) for immediate effectiveness a proposed rule change amending the trade reporting requirements relating to the submission of non-tape reports (*i.e.*, the transaction is not reported to the tape for publication) and clearing-only reports (*i.e.*, the transaction is not reported to the tape but may be submitted for clearing purposes).¹ In *Notice 07-33*, FINRA announced that the effective date of the rule amendments would be September 4, 2007. In response to feedback from firms, FINRA is extending implementation of the rule amendments until November 5, 2007.

As amended, with certain exceptions (discussed below), the trade reporting rules prohibit firms from submitting to a FINRA Facility (*i.e.*, the Alternative Display Facility, a Trade Reporting Facility (TRF)² or the OTC Reporting Facility) any report (including but not limited to reports of step-outs³ and reversals) associated with a previously executed trade that was not reported to that FINRA Facility.⁴ Among other things, this means that a firm cannot use a FINRA Facility to step-out of an exchange trade.⁵ For example, a clearing-only entry for a step-out relating to a trade executed on and reported through the NASDAQ Exchange cannot be submitted to the FINRA/NASDAQ TRF.⁶ Clearing-only reports that provide for the re-allocation or cancellation of a transaction that was previously reported to an exchange can make it more difficult for FINRA to tabulate accurately the aggregate dollar amount of its covered sales for purposes of Section 31 fees.⁷ Entry of these transactions in a FINRA Facility, when the original transaction was reported and assessed a Section 31 fee by an exchange, can result in the misalignment of Section 31 fees with the appropriate market and market participants.

Similarly, under the amended rules, firms are not permitted to report a trade to a FINRA Facility for submission to the National Securities Clearing Corporation (NSCC) for clearance and settlement purposes, if the trade was not reported to that same FINRA Facility for public dissemination or regulatory transaction fee assessment purposes. For example, except as discussed below, a member firm cannot tape report a trade to TRF A and use TRF B to clear that same trade.

Under the amended rules, there is an exception to the above-referenced prohibition for reports that reflect the offsetting, “riskless” portion of a riskless principal transaction and firms may continue to report such transactions as they do today.⁸ For example, where the initial leg of the transaction is executed on and reported through an exchange, a tape report will not be submitted to FINRA to reflect the initial leg; however, a firm may (but is not required to) submit a non-tape (or clearing-only) report for the second leg of the transaction to FINRA. Similarly, this exception applies if a firm is acting in an agency capacity on behalf of another member firm and the report is necessary to reflect the offsetting portion of the agency transaction.⁹ Thus, for example, similar to the riskless principal reporting structure, where Firm A, as agent for Firm B, executes a trade on an exchange (and that trade is reported to the tape through the exchange), Firm A may submit a non-tape (or clearing-only) report to FINRA to reflect the offsetting portion of the agency trade between Firm A and Firm B.

With respect to any transactions that do not fall within this exception, FINRA believes that the extended implementation date will provide sufficient time for firms to make alternative clearing arrangements, if necessary (*e.g.*, via Qualified Service Representative (QSR) agreements with NSCC).

Finally, FINRA has amended the trade reporting rules to clarify that where a tape and non-tape report for a riskless principal transaction (or, similarly, an agency transaction where a firm acts as agent on behalf of another member firm) are submitted to FINRA, firms are not required to submit both reports to the same FINRA Facility.¹⁰ As discussed in FINRA's filing, the current trade reporting rules could have the unintended consequence of requiring firms to be participants in all TRFs in order to comply with the trade reporting rules.¹¹ FINRA expects that where possible, firms will submit related tape and non-tape reports to the same FINRA Facility.

Endnotes

- 1 See Securities Exchange Act Release No. 55962 (June 26, 2007), 72 FR 36536 (July 3, 2007) (notice of filing and immediate effectiveness of SR-NASD-2007-040).
- 2 Currently, there are four TRFs in operation: the FINRA/NASDAQ TRF, the FINRA/NSX TRF, the FINRA/BSE TRF and the FINRA/NYSE TRF.
- 3 A step-out allows firms to allocate all or part of a previously executed trade to another broker-dealer. In other words, a step-out functions as a position transfer, rather than a trade; the parties are not exchanging shares and funds. The step-out function was designed and implemented to facilitate the clearing process for firms involved in these types of transactions. See, *e.g.*, *Notice to Members 05-11* (February 2005) and *Notice to Members 98-40* (May 1998).
- 4 See amendments to NASD Rules 6130 (new paragraph (i)), 6130A (new paragraph (d)), 6130C (new paragraph (h)), 6130D (new paragraph (h)) and 6130E (new paragraph (h)).
- 5 Exchange trades generally are considered trades executed on or through an exchange and are submitted for public dissemination purposes by that exchange. Trades executed by FINRA firms otherwise than on an exchange must be reported to a FINRA Facility for public dissemination purposes. See NASD Rule 5000.
- 6 Firms should consult the relevant exchanges to determine if they support such step-out functionality.
- 7 For example, as explained in *Notice to Members 05-11* (February 2005), as part of the step-out function, the transaction fee associated with a trade can be moved to the ultimate seller of the security when the trade is allocated.
- 8 For purposes of over-the-counter trade reporting requirements applicable to equity securities, a "riskless principal" transaction is a transaction in which a firm, after having received an order to buy (sell) a security, purchases (sells) the security as principal and satisfies the original order by selling (buying) as principal at the same price (the offsetting, "riskless" leg). A riskless principal transaction can be submitted as a single trade report marked as riskless principal, or as two separate reports: (1) a report that is submitted to the tape to reflect the initial leg of the transaction and (2) a non-tape (or clearing-only) report to reflect the offsetting, "riskless" leg of the transaction. See NASD Rules 4632(d)(3)(B), 4632A(e)(1)(C)(ii), 4632C(d)(3)(B), 4632D(e)(3)(B), 4632E(e)(3)(B) and 6620(d)(3)(B).

Endnotes

- 9 Since a riskless principal transaction is the functional equivalent of this type of agency transaction, the exception for riskless principal transactions under the amended rules extends to agency transactions where a firm acts as agent on behalf of another member firm.
- 10 See amendments to NASD Rules 4632(d), 4632A(e), 4632C(d), 4632D(e) and 4632E(e).
- 11 For example, assume Firm A is only a participant of TRF A and it executes the first leg of a riskless principal transaction otherwise than on exchange with Firm B, which is only a participant of TRF B. Assume further that Firm B has the reporting obligation under the trade reporting rules. The initial leg of the riskless principal trade will be reported by Firm B to TRF B. Firm A must report the second leg of the riskless principal transaction to FINRA, but because it is not a participant of TRF B, it cannot report the second leg to TRF B. The amended rules allow Firm A to report the second leg of the transaction to TRF A.