



Marcia E. Asquith
Executive Vice President,
Board and External Relations

Direct: [REDACTED]
Fax: [REDACTED]

April 19, 2022

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Via Email to rule-comments@sec.gov

Re: Comment Letter on Securities Exchange Act Release No. 94062 – Amendments Regarding the Definition of “Exchange” and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities (File No. S7-02-22)

Dear Ms. Countryman:

The Financial Industry Regulatory Authority, Inc. (“FINRA”) appreciates this opportunity to comment on the Securities and Exchange Commission’s (“Commission” or “SEC”) proposed amendments to the definition of “exchange” under Securities Exchange Act of 1934 (“Exchange Act”) Rule 3b-16 (the “3b-16 Proposal”), as well as the Commission’s re-proposed amendments to Regulation ATS for alternative trading systems (“ATSs”) that trade government securities (“Government Securities ATSs”) (the “ATS-G Re-Proposal”).¹

As detailed below, FINRA supports both the 3b-16 Proposal and the ATS-G Re-Proposal. FINRA believes that, by explicitly bringing communication protocol systems within the definition of “exchange,” the 3b-16 Proposal would address regulatory disparities among different types of trading systems and appropriately extend the investor protections provided by exchange registration or by the Regulation ATS framework (including FINRA membership) to such systems. FINRA also agrees that extending the Regulation ATS protections to currently exempted Government Securities ATSs, as proposed under the ATS-G Re-Proposal, would foster investor protection and market integrity by improving oversight of these ATSs by the SEC and FINRA.

¹ See Securities Exchange Act Release No. 94062 (January 26, 2022), 87 FR 15496 (March 18, 2022) (“Proposing Release”).

I. Support for the 3b-16 Proposal

The 3b-16 Proposal would amend Exchange Act Rule 3b-16 to, among other things, include within the definition of an “exchange” under the Exchange Act systems that utilize non-firm trading interest and structured communication protocols, including request-for-quote (“RFQ”) systems.² The proposed definitional change would significantly expand the scope of persons that would be required to either register as a national securities exchange or comply with the requirements of Regulation ATS (or an exemption therefrom under Rule 301(a) of Regulation ATS).³

As explained in the Proposing Release, the 3b-16 Proposal is, in part, intended to address issues raised by the Commission’s 2020 concept release on the electronic corporate bond and municipal securities markets (the “Concept Release”)⁴ and takes into consideration the comment letters submitted in response thereto.⁵ FINRA submitted a

² *See id.* at 15504. The Proposing Release provides a non-exhaustive discussion of the types of systems that may be considered communication protocol systems under the 3b-16 Proposal, including, in addition to RFQ systems, systems that electronically display continuous firm or non-firm trading interest (or “stream axes”), conditional order systems, and negotiation systems. *See id.* at 15500-01. Conversely, the SEC provided examples of systems that would not fall within the Rule 3b-16 criteria, including bulletin boards that passively display trading interest but do not provide means for buyers and sellers to contact each other and agree to the terms of the trade, as well as systems such as utilities or electronic web chat providers that display trading interest and provide only general connectivity among participants, without providing a trading facility to match orders or protocols for participants to communicate and interact. *See id.* at 15507-08.

³ *See* Exchange Act Rule 3a1-1. The ATS-G Re-Proposal would separately eliminate the existing exemption from the requirements of Regulation ATS for Government Securities ATSs under Rule 301(a)(4)(ii)(A) through (C) of Regulation ATS. *See* Proposing Release, *supra* note 1, at 15518 n.262. Thus, the combined effect of the 3b-16 Proposal and the ATS-G Re-Proposal is that systems trading government securities that do not currently fall within the definition of an “exchange” under Rule 3b-16—for example, RFQ systems for government securities—would now fall within the scope of “exchange” and, if seeking to avail themselves of the Regulation ATS exception under Rule 3a1-1, such systems would be required to comply with Regulation ATS, along with Government Securities ATSs relying on the existing exemption under Rule 301(a)(4).

⁴ *See* Securities Exchange Act Release No. 90019 (September 28, 2020), 85 FR 87106 (December 31, 2020).

⁵ *See* Proposing Release, *supra* note 1, at 15498.

comment letter in response to the Concept Release,⁶ in which FINRA noted its agreement with the recommendations of the SEC’s Fixed Income Market Structure Advisory Committee (“FIMSAC”) that regulators should take steps to harmonize the regulatory framework for all fixed income electronic trading platforms.⁷ In particular, FINRA noted the FIMSAC’s concern that there is currently different regulatory treatment among electronic corporate and municipal bond trading platforms because some are regulated as ATSS while others are regulated as non-ATS broker-dealers, and others are not regulated at all.⁸ FINRA therefore recommended that the Commission update trading platform classifications in line with the FIMSAC’s recommendations, and made several specific recommendations for the SEC’s consideration related to the treatment of RFQ activity as well as bulletin boards or electronic communication systems.⁹

FINRA strongly supports the 3b-16 Proposal and believes that it generally addresses FINRA’s key concerns regarding the inconsistent treatment of different types of fixed income trading platforms. By expanding the scope of the “exchange” definition to specifically encompass communication protocol systems utilizing non-firm trading interest and communication protocols to bring together buyers and sellers of securities, the 3b-16 Proposal would bring into the registered national securities exchange or Regulation ATS regulatory framework fixed income trading platforms that are not currently regulated as such. Such platforms would be required either to register as a national securities exchange or, as an ATS, would become subject to important investor protection provisions under Regulation ATS, such as fair access and capacity, integrity, and security requirements; requirements to establish written safeguards and written procedures to protect subscribers’ confidential trading information; and, depending on the types of securities traded on the

⁶ See Letter from Marcia E. Asquith, Executive Vice President and Corporate Secretary, FINRA, to Vanessa Countryman, Secretary, SEC, dated March 1, 2021 (“2021 FINRA Comment Letter”).

⁷ See *id.* at 6.

⁸ See *id.* FINRA noted the FIMSAC’s observations that RFQ platforms represent a large and growing fraction of electronic corporate and municipal bond trading but generally are regulated only as broker-dealers, not ATSS, and that at least one fixed income trading platform with significant volume in municipal and corporate bond trading does not fall under any regulatory oversight in the United States.

⁹ See *id.* at 7-10. First, FINRA recommended that the SEC could consider clarifying the classification of RFQ activity for purposes of Regulation ATS. Second, the SEC could consider clarifying whether an ATS may voluntarily include non-ATS activity within the ATS (especially if RFQ activity does not qualify as “exchange” activity). Finally, the SEC could consider clarifying the circumstances in which bulletin boards or electronic communication systems operate in a manner that warrants regulation as a non-ATS broker-dealer or as an ATS.

platform, the operational transparency requirements of Form ATS-N (applicable to ATSS trading NMS stocks and, under the ATS-G Re-Proposal, government securities).¹⁰ Moreover, as noted by the Commission, communication protocol systems would be required under Regulation ATS to register as broker-dealers and become FINRA members, thereby becoming subject to FINRA's oversight, investor protection rules, examination and market surveillance programs, and trade reporting rules.¹¹

As discussed above, FINRA believes that harmonizing the inconsistent regulatory treatment of different types of fixed income trading platforms is an important objective that would be addressed by the 3b-16 Proposal given the prevalence of platforms using non-firm trading interest and communication protocols in the fixed income market. Moreover, FINRA agrees with the Commission that the same principles apply to trading in any type of security, regardless of the specific characteristics of the security or how thinly traded or novel the security may be.¹² FINRA believes that, where a system provides services that meet the definition of an "exchange," trading occurring on or through such system should benefit from the protections afforded by exchange registration or by Regulation ATS with FINRA oversight.¹³

¹⁰ See Proposing Release, *supra* note 1, at 15502.

¹¹ See *id.* As FINRA noted previously, a number of FINRA requirements also apply specifically to member firms that operate ATSS. In particular, a fixed income ATS is a "party to a transaction" under FINRA's Trade Reporting and Compliance Engine ("TRACE") rules and has TRACE transaction reporting obligations, unless an exception or exemption applies. ATSS are also required to obtain a unique market participant identifier ("MPID") for purposes of reporting trades to TRACE, and, since 2016, FINRA has disseminated TRACE transactions with an identifier to indicate when a reporting party or contra-party is an ATS or when a trade that is exempt pursuant to Rule 6732 is executed on an ATS. See 2021 FINRA Comment Letter, *supra* note 6, at 6-7; see also *Regulatory Notice* 18-25, ATS Supervision Obligations (August 13, 2018).

¹² See Proposing Release, *supra* note 1, at 15503. As the SEC notes, Rule 3b-16 therefore applies to all securities, including government securities, corporate bonds, municipal securities, NMS stocks, OTC equity securities, private restricted securities, repurchase agreements and reverse repurchase agreements, foreign sovereign, and options.

¹³ ATSS trading NMS stocks must also use a separate MPID for purposes of reporting transactions to a FINRA Trade Reporting Facility ("TRF") or the Alternative Display Facility ("ADF"), and for purposes of reporting transactions in over-the-counter ("OTC") equity securities to the OTC Reporting Facility ("ORF"). Using data reported to the TRFs, ADF and ORF, FINRA publishes aggregated trade

Finally, as noted above, the Proposing Release clarifies that systems that passively display trading interest but that do not provide a means for buyers and sellers to contact each other and agree to the terms of the trade, such as bulletin boards, would not be captured by amended Rule 3b-16.¹⁴ FINRA appreciates this clarification and recommends that the SEC consider further clarifying the circumstances under which a bulletin board would be subject to regulation as a non-ATS broker-dealer, for example by providing updated guidance, with examples, that identifies any determinative factor or mix of factors that require registration as a broker-dealer.¹⁵

II. Support for the ATS-G Re-Proposal

The ATS-G Re-Proposal would rescind the existing exemption from the requirements of Regulation ATS currently provided in Rule 301(a)(4) for Government Securities ATSS, while also re-proposing, with certain modifications, specified requirements applicable to Government Securities ATSS.¹⁶ For example, in addition to the general Regulation ATS requirements, Government Securities ATSS would be subject to the enhanced disclosure and filing requirements of Rule 304 of Regulation ATS, and Government Securities ATSS with significant volume in U.S. Treasury Securities or Agency Securities would be required to comply with the fair access rule under Regulation ATS and with Regulation SCI. The ATS-G Re-Proposal would also require Government Securities ATSS to file and make public disclosures on Form ATS-N (rather than new Form ATS-G, as originally proposed), and would make several changes to Form ATS-N that would require NMS Stock ATSS to file amendments to their existing disclosures on Form ATS-N.

In the 2021 FINRA Comment Letter, FINRA expressed its strong support for the original ATS-G proposal and its extension of the Regulation ATS regulatory and FINRA membership framework to all Government Securities ATSS, and lauded the improvement in the level of transparency concerning the operations of such platforms that would result.¹⁷ FINRA strongly supports the ATS Re-Proposal, and reiterates and incorporates by reference its comments in the 2021 FINRA Comment Letter. Below FINRA provides

volume and other information about OTC trading in NMS stocks and OTC equity securities on its website.

¹⁴ See Proposing Release, *supra* note 1, at 15507.

¹⁵ See 2021 FINRA Comment Letter, *supra* note 6, at 9-10.

¹⁶ See Proposing Release, *supra* note 1, at 15498.

¹⁷ See 2021 FINRA Comment Letter, *supra* note 6, at 2-4.

specific additional comments on two aspects of the ATS-G Re-Proposal that differ from the original ATS-G proposal.

First, the ATS-G Re-Proposal would amend Rule 301(b)(1) to allow an ATS to register either as a broker-dealer under Exchange Act Section 15¹⁸ or a government securities broker or government securities dealer (“GSBD”) under Exchange Act Section 15C(a)(1)(A).¹⁹ FINRA agrees with the Commission’s proposal to allow Government Securities ATSs to register as GSBDs under Section 15C(a)(1)(A), which requires membership in an SRO²⁰ (and, conversely, not to allow registration under Section 15C(a)(1)(B), which does not require SRO membership).²¹ As noted by the Commission in its recent proposal related to the “dealer” definition, government securities currently are not traded on exchanges, and therefore entities trading only government securities must become members of a registered national securities association.²² FINRA agrees that membership in a registered national securities association is important to provide for effective oversight of such entities, including Government Securities ATSs. Specifically,

¹⁸ With limited exceptions, broker-dealers registered under Section 15 must become members of FINRA. Under Exchange Act Section 15(b)(8), broker-dealers registered under Section 15 are required to become members of a national securities association (of which currently the only one is FINRA). There are two cases where broker-dealers may be exchange-only self-regulatory organization (“SRO”) members. First, there is a statutory exception for a broker-dealer that transacts business solely on an exchange of which it is a member. *See* 15 U.S.C. 78o(b). Second, there is a rule-based exemption for firms that carry no customer accounts and conduct limited off-exchange business. *See* 17 C.F.R. 240.15b9-1.

¹⁹ *See* Proposing Release, *supra* note 1, at 15518.

²⁰ *See* Exchange Act Section 15C(e)(1).

²¹ *See* Proposing Release, *supra* note 1, at 15519.

²² *See* Securities Exchange Act Release No. 94524 (March 28, 2022), 87 FR 23054 (April 18, 2022) (Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer), at 23060 n.75 (“Section 15C(e)(1) of the Exchange Act requires that a registered government securities broker-dealer, other than certain financial institutions, become a member of a registered national securities exchange or registered national securities association. Because government securities are not traded on registered national securities exchanges, a person that registers as a government securities dealer under Section 15C to trade only government securities would need to become a member of a registered national securities association (FINRA is the only registered national securities association).”). FINRA requests that the Commission make the same clarification in the context of the ATS-G Re-Proposal.

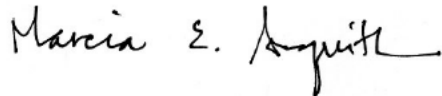
and as discussed in the 2021 FINRA Comment Letter, FINRA continues to believe that requiring Government Securities ATSS to become FINRA members would enhance the regulatory audit trail and public transparency for transactions in government securities through the application of FINRA's TRACE reporting rules, as well as extending the benefits of FINRA's investor protection rules and examination and surveillance programs to such ATSS.

Second, the ATS-G Re-Proposal would require a Government Securities ATS to file Form ATS-N, rather than Form ATS-G as originally proposed, and would make certain modifications to Form ATS-N that would also apply to NMS Stock ATSS that also file Form ATS-N. FINRA agrees with the Commission that requiring both Government Securities ATSS and NMS Stock ATSS to file the same Form ATS-N would simplify filing requirements given the significant overlap with the previously proposed Form ATS-G.²³ FINRA also supports the proposed changes to Form ATS-N to add questions about interaction with related markets, liquidity providers, and surveillance and monitoring, which will provide further transparency into key aspects of the operations of both Government Securities ATSS and NMS Stock ATSS. For example, FINRA agrees with the SEC's statement that highlighting whether the broker-dealer operator or affiliate acts as a liquidity provider on the ATS would help market participants evaluate the potential for conflicts of interest or information leakage on the trading platform.²⁴

III. Conclusion

FINRA thanks the Commission for its attention to FINRA's comments on the 3b-16 Proposal and the ATS-G Re-Proposal, and looks forward to continued engagement with the SEC and other regulators on these important regulatory matters. If you have any questions or would like to further discuss FINRA's views and comments, please contact Racquel Russell, Senior Vice President and Director of Capital Markets Policy, FINRA, at [REDACTED] or Robert McNamee, Associate General Counsel, FINRA, at [REDACTED].

Sincerely,



Marcia E. Asquith
Executive Vice President,
Board and External Relations

²³ See Proposing Release, *supra* note 1, at 15498 n.21.

²⁴ See *id.* at 15545.