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Via email: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

July 17, 2014

RE: File Number SR-FINRA-2014-025:

Supplemental Inventory Schedule

Integrated Management Solutions USA LLC (“IMS”)<sup>1</sup> is pleased to comment on FINRA’s proposed Supplemental Schedule to FOCUS Report or FOGS Report, entitled Supplemental Inventory Schedule or SIS. Its stated purpose is to “enhance FINRA’s ongoing surveillance monitoring of firms’ financial condition by providing greater transparency into the market risk posed by a firm’s inventory positions...” and to “enable FINRA staff to perform more targeted examinations of firms’ market risk exposure.”

IMS is one of the largest providers of financial accounting and compliance consulting services to the securities industry, providing such services to about 100 FINRA members. We prepare and/or file FOCUS Reports routinely on behalf of our clients and have been doing so for many years. In addition, we interface with FINRA examiners and coordinators whose efforts to gain adequate knowledge about the firms that they regulate are frustrated by the relative lack of

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<sup>1</sup> The statements in this comment letter incorporate the views of IMS, not those of our clients.

significant data reported in the FOCUS Report, which uses a format that is, at least theoretically, the design of the SEC.

We previously commented to FINRA with respect to Regulatory Notice 13-05 when the SIS was first proposed. We believe that our regular, daily experience with FINRA reporting requirements and how they are used by FINRA itself provides hands-on knowledge to assess the impact of the proposed SIS form on FINRA member firms from both a regulatory and business perspective.

### **Usefulness of the SIS**

Currently, the financial instrument information reported on the SEC's FOCUS Report, which has been virtually unchanged for about 40 or more years, is so lacking in granularity as to render it relatively useless as a regulatory tool in many instances. To gain any meaningful understanding of the information reported, regulators often must request further information from FINRA members. It would be more effective for all concerned to provide better and more meaningful information in the first instance. The SIS form is designed to be the vehicle that accomplishes that goal.

In our previous comments, we complimented the drafters of the proposed form for its very creation and, in particular, for certain items such as requiring comprehensive reporting of short positions, which on the SEC's FOCUS Report appear on but a single line. We also commented earlier that without a set of instructions, we could not comment effectively on the proposed form.

While FINRA did consider our comments, and those of the three other commenters, we believe that FINRA's response did not go far enough.

The form, as now proposed, is vastly improved from the earlier version. For one thing, Item 11, calling for values of “Derivatives including Options” has been significantly expanded. Firms that have large amounts of these positions to report will need to break these down categorically. Presumably, this will provide the regulators with significantly more useful information.

What remains of particular concern to us is that the amended version of the SIS itself and the newly-issued instructions to the amended version of the SIS, in many, if not most, cases, do not help to discern the value of positions that have the direct or indirect effect of offsetting the risk of other positions. In particular, in our last comment letter with respect to the SIS form, we noted that there was a line entitled “Arbitrage,” but with no definition of what that meant.

#### **Arbitrage is not a Four-Letter Word**

In the newly-issued instructions for the SIS, FINRA has sought to remedy this definitional deficiency. Regrettably, however, FINRA’s definition of “Arbitrage” is somewhat pitiful. It defines arbitrage in terms of “securities that are traded on the firm’s arbitrage trading desk” but further qualifies the definition by limiting the definition only to firms that have “a separate [emphasis added] arbitrage trading desk.” We are baffled as to why having a separate arb desk is an important, or useful, criterion. Many trading firms have significant portfolios where all or most of their positions are, effectively, one big arbitrage position. But FINRA’s definition in that regard would be useless and would not provide FINRA with a realistic means of assessing the activities of the trading firm or any risks posed by such activities. And, we note, these positions do not require initiation from a separate desk.<sup>2</sup>

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<sup>2</sup> Many firms today engage in algorithmic trading conducted automatically by computers that don’t sit at any desk, let alone an arbitrage desk.

SIS should take into account the broad range of arb strategies, from an economic point of view. Some examples of typical groups of positions that have offsetting risk characteristics are:

- U.S. Treasury securities vs. high-grade corporate securities
- Long puts and long underlying stocks
- Short calls and long underlying stocks
- Long calls and short underlying stocks
- Short puts and short underlying stocks
- Convertible bonds and underlying stocks
- Exchange traded funds offsetting underlying components or even other exchange traded funds
- Futures offsetting baskets of underlying securities components
- Futures offsetting spot commodities
- Etc.

Nowhere on the newly proposed SIS form are these types of offsetting positions notated in any way. The breakdown of certain derivative positions, e.g., futures, calls for reporting the mark-to-market receivables and payables related to those positions but does not indicate how those positions might interrelate to any other positions. Therefore, a basket of stocks with a value of, for example \$1,000,000, that offsets a future that has a mark-to-market receivable or payable of only \$1 would appear to be quite unhedged and risky even though the market exposure on both positions might significantly offset each other. Using gross values reported on the SIS form are not very informative.

### **What IMS recommends**

We wouldn't presume to criticize the significant and positive efforts of the regulators without offering an acceptable and efficient solution. We propose that the SIS form be oriented horizontally in a so-called landscape format. To the side of the long and short columns would be a column labeled "Arbitrage" or "Offsets". That column could be used, at each reporting firm's option, to indicate how much of the gross market value reported in the long or short columns represented positions that were offsets or related to other positions, directly or indirectly.

Although the determinations of what would be reported would be somewhat subjective, it would be informative, assuming such determinations are made consistently by each firm. Most importantly, the disclosure of values that are of an offsetting nature would be voluntary. Many firms should be delighted to inform regulators that the gross positions entered on the SIS form are not that ominous because, in the firm's view, the economic risks of the gross positions have been hedged. We believe this will minimize inquiries by a firm's Regulatory Coordinator as to each firm's overall risk.

Most importantly, line 10 and the parenthetical description on line 9 of the SIS form should be eliminated and the restrictive definition of Arbitrage in the instructions be changed to indicate something to the effect that arbitrage is whatever the reporting firm thinks it is. We trust that firms will define "arbitrage" better than the regulators. Economic risk is most certainly not, as a business matter, a function of maintaining a distinct arbitrage desk. Nor is this approach either arbitrary or merely subjective because it reports to the regulators what the firm believed was the economic value – and risk – of the particular series of positions as they were booked by the firm. The regulators should be evaluating existing positions with whatever existing economic risks existed in the first place or which could result from market fluctuations. This is exactly what the SIS form is intended to do.

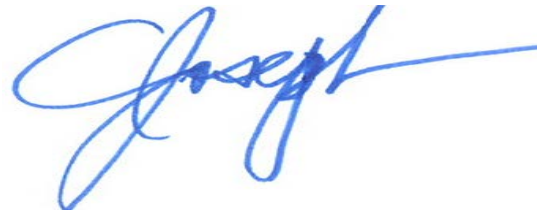
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Thank you for the opportunity to comment on the proposed SIS form and its instructions. Should you have any further questions, please feel free to call Howard Spindel at 212-897-1688 or Cassondra Joseph at 212-897-1687, or contact us by e-mail at [hspindel@intman.com](mailto:hspindel@intman.com) or [cjoseph@intman.com](mailto:cjoseph@intman.com), respectively.

Very truly yours,

A handwritten signature in black ink, appearing to be 'H Spindel', with a stylized, overlapping structure.

Howard Spindel  
Senior Managing Director

A handwritten signature in blue ink, appearing to be 'Cassondra E. Joseph', with a long, sweeping horizontal line extending to the right.

Cassondra E. Joseph  
Managing Director