FINANCIAL INFORMATION FORUM

5 Hanover Square
New York, New York 10004

212-422-8568

<u>Via Electronic Delivery</u>

Mr. Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

January 25, 2016

Re: SR-FINRA-2015-048; Release No. 34-76484; Notice of Filing of a Proposed Rule Change To Adopt FINRA Rule 6191(b) and Amend FINRA Rule 7440 To Implement the Data Collection Requirements of the Regulation NMS Plan To Implement a Tick Size Pilot Program

Dear Mr. Errett,

On behalf of Financial Information Forum ("FIF")[1] non-exchange industry members, I am writing to make the Securities and Exchange Commission ("the Commission" or "the SEC") aware of recent developments in connection with the implementation of the Market Makers' Transaction Reporting requirements of the Tick Size Pilot as proposed in the Financial Industry Regulatory Authority, Inc. ("FINRA") rule filing SR-FINRA-2015-048. It should be noted that the Commission has not yet approved the proposed FINRA rules, but instead has designated a longer period "within which to take action on the proposed rule change so that it has sufficient time to consider the proposal." FIF also understands that FINRA intends to amend their rule filing in light of the changes made to submission requirements. Publication of new technical specifications has caused significant concern, and impacts Market Makers' ability to meet the effective date of April 4, 2016 for transaction reporting. Industry participants will also need sufficient time once the Commission takes action to consider the final requirements and make necessary changes to their systems.

FINRA has done much to assist the industry in addressing the data collection and reporting components of the National Market System ("NMS") Plan to implement a Tick Size Pilot Program ("the Plan"). FIF non-exchange members are appreciative of FINRA's efforts and FINRA's willingness to discuss issues and answer members' questions. The requirements of this Plan are exceedingly complex, and in order to fulfill the requirements of the Plan in the way they have been interpreted, FINRA must attempt to establish linkages using data from multiple sources and disparate systems. To accomplish this, FINRA recently found it necessary to change the technical specifications for market makers' transaction reporting. The new specs were published on January 11, 2016[2], giving market makers less than three months to fully implement the transaction reporting requirements; a timeframe too short to achieve with any degree of confidence.

[1] FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact financial services and technology firms. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues to arrive at productive solutions to meet the requirements of new regulations, technology developments, and other industry changes.

[2] http://www.finra.org/sites/default/files/market-maker-transaction-data-tech-specs.pdf

FIF members believe that the details stipulated in the new technical specifications have complicated the process for collection and reporting market makers' statistics such that it is difficult for market makers to comply, especially within the compressed timeframe. Specifically, there are two requirements that have made implementation significantly more problematic and costly: a) identification of ultimate execution venues where market makers did not initially direct their orders; and b) exclusion of the principal leg in certain riskless principal transactions. In addition to the development expense, the industry will incur ongoing costs associated with identifying, collecting, analyzing, repairing and maintaining the data. It has not been demonstrated that the anticipated ongoing costs to the industry are commensurate with any benefit that may be derived; and, the considerable complexity and related costs could ultimately bias the study against enhancing liquidity in the pilot stocks by discouraging existing and new market makers from participation.

This letter is intended to request additional sufficient time for industry implementation, highlight the issues with the requirements for Market Makers' Transaction Reporting as currently proposed, and provide recommendations that would *simplify the process without impacting the value of the results*.

1. Timeframe
   Given the recent specification changes, there is insufficient time to complete implementation of the Market Maker transaction file (based on current specifications and related guidance) by the effective date of April 4, 2016.
2. Identifying the Ultimate Execution Venue
   The addition of new fields to the technical specifications that are needed to identify the ultimate execution venue is adding complexity that impacts members' ability to meet the April 4th effective date. FIF members suggest that the ultimate execution venue, in cases where the order was not directed by the market maker to that ultimate execution venue, should not be included in the participation statistics.
3. Repair of Unlink Messages
   FINRA will return a file of "unlinked" records that must be corrected and resubmitted within three business days. FIF members contend that correcting a mismatched record would be resource intensive and provide little added value. Assuming however that this remains a requirement, FIF requests a grace period for the process to mature, and that the requirement to correct unlinked records be waived once an acceptable match threshold has been achieved.
4. Riskless Principal Transactions
   Guidance provided by FINRA indicates that both Principal and Customer legs of Riskless Principal transactions should be excluded from the Market Maker transaction file in order to meet the requirements set forth by Appendix B.IV of the Plan. Given existing business practices and workflows, the proposed approach cannot be accomplished with any reliability in cases where the customer leg of a riskless trade is not systemically paired with the principal leg. FIF discusses the circumstances and proposes an alternate solution below.

The following supports FIF members' perspectives on each of these topics.

Timeframe

The Market Maker Transaction Data Technical Specification ("Spec") was finalized for publication on January 11, 2016, allowing less than three months for analysis, programming, testing and deployment (a draft of the revised spec was first distributed on December 29, 2015).The final spec contains differences that are significant enough to render useless much of the work done on the original spec that was published in October. Many firms had begun programming using the October spec in order to be ready for the April 4 effective date. These late changes are proving to be both costly and difficult.

The greatest challenge comes with the fact that the spec has added a number of fields involving a mix of order data and execution data, which typically reside in different systems. This makes the reports more difficult and time-consuming to code and test.

For example, the new spec added the following fields to the report that were not included in the October spec: Routed Order ID, Connection ID (optional) and Order Sent Date (if the order related to the trade was routed on a date prior to the trade date). These fields are associated with orders, not executions. Many FIF members will encounter issues with pulling original order-related data when reporting trades on the Market Makers Transaction file.

An Order Entry Firm Identifier field has been added as well, requiring mnemonics that are not received with the trade execution message. This information might not be maintained in a field that is readily accessible, but instead could be contained within text on an audit trail, or only on the FIX message sent to the trading center. Furthermore, some industry participants utilize more than one order and execution management system to receive orders and access exchanges, and in these cases, enhancements may be needed in order to ensure information necessary to the Market Maker Transaction file is captured in one system and passed back to the other.

While all this information can be looked up and applied, it is yet another aspect of the process that must be analyzed, mapped, coded and tested in what has become an unrealistically short timeframe. FIF indicated in its comment letter of December 16, 2015 that our members' ability to meet the April 4, 2016 effective date would be at risk if there were to be significant modifications to the specs, or if new fields were added.[3] In fact, as described above, FINRA's latest spec has added new fields which require data that is not readily available.

FIF members understand the reason FINRA has taken this new approach is to support the Plan requirements as they have been interpreted; that is, to reflect the ultimate execution venue in the Market Makers' participation statistics. Unfortunately, because the information necessary to report the ultimate execution venue is not consistently provided to market makers, FINRA has modified the specs to obtain the information it needs to link the transactions to OATS reports filed by various execution venues. FIF's previous comment letter highlighted this issue, warning that spec changes or additional fields needed to accomplish this would extend the implementation timeframe.[4]

In addition to the issues presented by the Market Maker Transaction spec changes, there have been recent modifications to the OATS spec. Changes in definitions of certain Special Handling Codes will require further clarification, and potentially remapping and reprogramming. Added to FIF

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[3] FIF comment letter pg. 2. "FIF members' ability to comply with the data collection and reporting rules proposed in SR-FINRA-2015-048 and a primary concern rests on one overarching and critical assumption: the specifications for modifications to OATS and the *Market Makers' Transaction files designed to meet requirements of the Tick Size Pilot, will include no fields other than those presented in the specs published on October 12, 2015. In order to meet the April 4, 2016 date, our members have begun analysis and programming. Additional changes, particularly if they require capturing new data fields that are not readily available in firms' current workflows and related systems, could put at risk many firms' ability to implement by April 4, 2016."*

[4] FIF comment letter pg. 5. "Considering the ultimate execution venue is often unknown to the broker dealer that routed an order, we appreciate that FINRA's requirement under Rule 6191(b)(5) to populate the "Trading Center where the trade was executed" was written to allow "the destination where the order was originally routed for further handling and execution." FINRA has indicated it can establish the necessary linkages to identify the ultimate execution venue. FIF members are concerned, however, that to accomplish this, FINRA will require Market Makers to capture new data, or that new fields or reports must be created beyond that which has been published in the Market Maker Transaction Data Technical Specification. *Members may not be able to submit the required information by April if any new fields or report formats not already included in the specs published on 10/12/2015 are added to establish the ultimate execution venue."*

members' concerns related to the timeframe for implementation, is the fact that none of these rules related to Tick Size Pilot have been approved; therefore, we have no certainty that the rules set forth to date, the specifications we are now working from, or the guidance provided in the FAQs, are in their final form as currently presented.

Identifying the Ultimate Execution Venue

The process necessary to derive the ultimate execution venue has become quite convoluted and unwieldy, especially for FINRA. FIF members who are market makers suggest these extra steps being taken will apply to comparatively few trades, and the added information this process will yield is de minimis and potentially inaccurate. We do agree that market makers' activity is relevant when conducted on venues where a market maker is registered as well as those venues where the market maker is not, so long as it is the market maker directing trades to those venues. However, in what FIF members believe will be a rare and unlikely event if not working a client order, when a market maker sends an order to a third-party algorithm which routes the order to an exchange, this indirect activity should not be included in the participation statistics. Similarly, when a market maker routes an order to an exchange, and that exchange reroutes the order to a second exchange, FIF's industry members believe that such indirect activity, where a market maker's order has been routed from one execution venue to another unbeknownst to the market maker, should be not be reflected in the market makers' participation statistics.

FIF members who are market makers believe the late changes in the technical specifications, particularly the introduction of new fields, are adding complexity that impacts their ability to complete the work with confidence in its accuracy by the effective date of April 4, 2016. As suggested in FIF's previous letter[5], the need to link to the ultimate execution venue in cases where the order was not directed by the market maker should be eliminated, as well as the requirement to repair "unlinked" records to validate the ultimate execution venue. These requirements: a) do not agree with the industry's interpretation of market makers' activity; b) add significantly to the complexity and ongoing costs; and c) will have de minimis impact on the participation statistics.

In order to implement the new specs and expedite development, further clarification is needed, by venue and by interface, on how to populate the fields that will be used by FINRA to track the flow of the transaction. Specifically, we are looking for clear, protocol-level guidance on each of the fields that will be used for linking, similar to the type of guidance FINRA has provided for OATS. It is important that this guidance be received as soon as possible and documented (perhaps in the form of a table) as part of FAQs or technical specifications for the market makers to implement a viable solution and minimize the instances of unlinks.

Repair of Unlink Messages

As described above, FINRA is tasked with establishing linkages to determine the ultimate execution venue for B.IV reporting of participation statistics, even when there was no direct participation by a market maker on the execution venue. In order to establish the links, FINRA must apply complex

[5] FIF comment letter pg. 6. "Because these specifications are complex to develop, and more importantly, the linkages are difficult for FINRA to code, FIF members are concerned that this portion of the requirements cannot be completed in the limited time remaining. This set of requirements impacts only the Market Maker Participation Statistics, and not the Profitability Data. The assumption that the functionality needed to identify the ultimate execution venue can be met by April 4, 2016 may be unrealistic; and, focus on accomplishing this aspect of the rule while leaving other critical issues unresolved could jeopardize the entire project's completion date. *FIF suggests that this portion of the Rule and associated requirements be temporarily waived or perhaps eliminated from the pre-Pilot data collection and reporting phase, until all other components are complete, and until the details on how the linkages can be established are further developed."*

logic to input received from multiple sources. FINRA will return a file of "unlinked" records to the market makers that must be corrected and resubmitted within three business days. The requirement to correct "unlinks" is a departure from the OATS process where mismatches are published and firms work to resolve the issues that cause them, but the mismatches themselves are not repairable.

We do agree that it is important early in the process to identify the root cause of unlinks and to correct the underlying issues. However, FIF members contend that correcting the unlink records themselves will be resource intensive and provide little added value. Resolution of unlinks will require skilled resources to track down and resolve with the counterparty where possible, and firms anticipate the need to hire specialized personnel to address the issues.

Assuming, however, that resolution of unlinked records remains a requirement, FIF members request: a) a "grace period" to allow the kinks to be worked out while in production; and, b) a "threshold" for accuracy, beyond which unlinked records need not be repaired.

FIF members are concerned that this new, untested process could initially produce numerous unmatched records; for example, once in production, there could be a systemic issue that causes tens of thousands of trades to remain "unlinked". Without adequate testing of the linkages industry-wide, significant time and resources could be spent fixing these records once we are in production. We ask FINRA and the Commission to establish a "grace period" of 1-2 months during which time unlinks do not need to be repaired.

FIF also requests that the need to correct unlinked records be waived once an acceptable match threshold has been achieved. For example, after years of operation, less than 1% of OATS transactions reported require remediation. FIF members do not believe that a similar level of accuracy should be required for the market maker statistics. Given this is a statistical study across market participants and is not used for surveillance, an accuracy rate of 90% should be acceptable, as minor differences in a market maker's participation rate will not materially change statistical deductions. FIF suggests that once a firm has reached a 90% match rate, correction of unlinked records should not be required.

Riskless Principal Transactions

FINRA's FAQs provide guidance that riskless principal transactions should be excluded from the market maker transaction file in order to meet the requirements of the SEC's Order.

> "Appendices B.IV and C of the Plan require principal trades, not including riskless principal, to be included in the market marker participation and profitability statistics. Therefore, trades relating to riskless principal executions conducted by a market maker should not be included in the Market Marker Transaction file." [6]

In cases where both legs of the riskless principal transactions are systematically processed and linked in an automated fashion, there should be no issues in removing these trades from the file. However, there are certain transactions that cannot be systematically paired. Often in cases where shares have been accumulated over the trading day on a principal basis, and later flipped to one or more customers at an average price on a riskless basis, it is difficult for a market maker to link the riskless legs to the principal trades. Trades are sometimes handled in this manner because the terms of compensation are not determined until the order is complete and all the shares have been accumulated. The determination as to whether the trade is done on a riskless basis, or on a

[6] FINRA Market Maker Reporting FAQ #4.

principal basis, would be made post trade, and could depend on how well the trader did in filling the customer order.

Following are two examples of this situation:

Example 1: market maker accumulates a position as principal and then allocates to customer on riskless principal basis

Market Maker A (MMA) receives a Not Held order to buy 1000 ABCD @ market.
MMA buys 500 @ 53.00 as principal from NSDQ. Execution is not systematically passed back to customer order. Execution is flagged as reportable on the market maker transaction file.
MMA buys 500 @ 53.10 as principal from BATS. Execution is not systematically passed back to customer order. Execution is flagged as reportable on the market maker transaction file.
The trader then fills the 1000 share customer order @ 53.05 as riskless principal. The riskless principal fill is *not* reportable on the market maker transaction file.
The firm would now be tasked to go back and find the original principal fills vs. NSDQ and BATS and change them to non-reportable.

Example 2: market maker accumulates a position as principal and then partially allocates to customer on riskless principal basis

Market Maker A (MMA) receives a Not Held order to buy 800 ABCD @ market.
MMA buys 500 @ 53.00 as principal from NSDQ. Execution is not systematically passed back to customer order. Execution is flagged as reportable on the market maker transaction file.
MMA buys 500 @ 53.00 as principal from BATS. Execution is not systematically passed back to customer order. Execution is flagged as reportable on the market maker transaction file.
The trader then fills the 800 share customer order @ 53.00 as riskless principal. The riskless principal fill is *not* reportable.
The firm would now be tasked to go back and find the original principal fills vs NSDQ and change it to non-reportable and also find a way to mark part of the BATS execution as non-reportable (300 as non-reportable and 200 as reportable).

In other cases, so called "Manning" rules could be a factor in determining the price at which stock was traded or flipped. Firms are required, pursuant to FINRA rule 5320, to "execute[s] the customer order up to the size and at the same or better price at which it traded for its own account." This can result in riskless transactions. Certain FIF members effect these riskless transactions without electronically linking them; that is, the customer sides of these riskless trades are not linked electronically to the principal trades to which they are associated. Significant work is required to change their systems so both legs of these transactions can be removed from the market maker transaction file. This work cannot be accomplished by April 4, 2016.

FIF believes that if both legs are reported in the transaction file, whether identified as riskless principal or not, calculation of profitability statistics would *not be negatively impacted*, as the principal transactions would be offset by the riskless principal trades. Without removing any of the trades marked as principal or riskless principal, FINRA's profitability calculations would be unchanged for purposes of Appendix C reporting.

The challenge for FINRA however, is the requirement to provide market maker participation statistics under Appendix B.IV. The Plan specifies that participation statistics must include: "a) Share participation: the number of shares purchased or sold by market makers in a principal trade, not including riskless principal; and, b) Trade participation: the number of purchases and sales by market makers in a principal trade, not including riskless principal."

While the trades marked as “Riskless Principal” included on the market maker transaction file can easily be eliminated from these calculations, the associated principal trades that were accumulated during the day and not electronically linked to the riskless legs cannot be identified, and will therefore be included in the file and the calculations. FIF members believe that there is justification in keeping these “Principal” trades in the calculations. The B.IV statistics are intended to include trades where the market maker is “at risk”. The shares accumulated in the principal account described in Examples 1 and 2 above have placed the market maker at risk for a period during the trading day, and FIF market makers believe these trades should therefore be reflected in the B.IV participation statistics.

For these reasons, FIF proposes that where riskless and principal legs can be linked, they should be removed from the market maker transaction file; however, where they cannot be definitively linked, both the principal legs and the riskless legs should remain in the market maker transaction file. Those that were not systemically linked will net out in the Appendix C profitability statistics calculated by FINRA. For the B.IV calculations, the riskless principal trades to the customers should be eliminated by FINRA; but, it is appropriate that the street side principal trades remain because the market makers have put their capital at risk.

In summary, FIF members are troubled by the narrow timeframe they have to prepare for market maker transaction reporting, as well as the complexity involved with meeting the requirements of the new FINRA specs. We believe the need to identify the ultimate execution venue in some cases is unnecessary, and the need to repair unlinked trades adds significantly to the cost of compliance with the Pilot. Additionally, the requirement to remove all legs of a riskless principal transaction can only be accomplished with great difficulty and at a high cost. We trust the Commission will consider these concerns and weigh the benefits of the less complex alternatives suggested by our members.

Thank you for the opportunity to bring these important matters to the attention of the Commission. Please do not hesitate to contact me at ([redacted] to arrange for follow up discussions.

Regards,

Mary Lou Von Kaenel

Mary Lou Von Kaenel
Managing Director
Financial Information Forum

cc: The Honorable Mary Jo White, Chair
The Honorable Luis A. Aguilar, Commissioner
The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner
Stephen Luparello, Director, Division of Trading and Markets
Gary Goldsholle, Deputy Director, Division of Trading and Markets
David S. Shillman, Associate Director, Division of Trading and Markets