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## Trade Reporting: SEC Approves FINRA Rule Requiring Alternative Trading Systems to Report Activity Weekly

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**US-registered broker-dealers that operate Alternative Trading Systems will have to report volume information, by security, to FINRA weekly. The first report, for the week of May 12, 2014, is due May 28, 2014. ATS will, by November, require their own separate Market Participant Identifier (or “MPID”).**

### Introduction

#### Summary of New Rules

On January 17, 2014, the US Securities and Exchange Commission (“SEC”) voted to approve a FINRA rule proposal that significantly changes the regulatory landscape for broker-dealers that operate as alternative trading systems, or ATSs.<sup>1</sup>

The rule changes cumulatively require each ATS to report weekly volume information and number of securities transactions, by security, and also require broker-dealers operating as ATSs to acquire and use a single, unique market participant identifier (“MPID”) when reporting information to FINRA.

#### Effective Date of May 2014 for the New Reports

The ATS reporting requirement will be implemented beginning May 12, 2014. The first ATS reports for the week of May 12 through May 16, 2014, will then be due by May 28, 2014.

Each ATS must begin reporting order and trade information to FINRA using a unique MPID by November 10, 2014.

<sup>1</sup> See SEC Release 34-71341, “*Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Require Alternative Trading Systems to Report Volume Information to FINRA and to use Unique Market Participant Identifiers*,” January 17, 2014.

SEC releases are available at the SEC’s website, [www.sec.gov](http://www.sec.gov).

## Summary of New FINRA Rules

The new FINRA rules create a significant new regulatory reporting requirement for ATSs.

### Reporting Requirement

Under new FINRA Rule 4552, each ATS must report to FINRA its total (i.e., aggregate) weekly volume information and number of trades, by security, in both equity and fixed-income securities, provided that such securities are subject to trade-reporting requirements.<sup>2</sup> The trading information with respect to any week must be filed with FINRA within seven business days following the end of each week.

FINRA will make the reported information for equity securities publicly available on a delayed basis. Specifically, FINRA will publish the trading information reported for certain equity securities after a minimum delay of two weeks (for NMS stocks in Tier 1 of the NMS Plan to Address Extraordinary Market Volatility) and after a minimum delay of four weeks for other equity securities.<sup>3</sup>

Under the rule, an ATS must include only those trades executed “within the ATS,” and not those transactions routed outside the ATS.<sup>4</sup> The FINRA Regulatory Notice describing the new rule explains that volume is considered to be “within an ATS” for purposes of Rule 4552 if the ATS (i) executes the trade; (ii) is considered the “executing party” to the trade under FINRA rules; or (iii) otherwise matches orders constituting the trade in a manner as contemplated by SEA Rule 3b-16 or SEC Regulation ATS.<sup>5</sup> The Regulatory Notice states:

“For example, a trade would be considered to have occurred ‘within an ATS’ for purposes of Rule 4552 if the ATS uses established, non-discretionary methods under which orders interact with each other, and the buyers and sellers entering the orders agree to the terms of the trade. The Supplementary Material [found in the Rule] notes that this standard would include, but not be limited to: any trade executed as a result of the ATS bringing together the purchaser and seller on or through its system; any trade executed by the ATS’s subscribers where the subscribers used the ATS to negotiate the trade, even if the ATS did not itself execute the trade; or any trade in which the ATS takes either side of a trade for clearing or

<sup>2</sup> Specifically, reporting is required for any NMS stock, OTC Equity Security, and any debt security subject to FINRA’s Trade Reporting and Compliance Engine (TRACE) rules (i.e., “TRACE-eligible” securities). Note that reporting securities in accordance with FINRA Rule 4552 does not exempt the reporting ATS from applicable trade reporting rules in respect of the same transactions.

<sup>3</sup> So-called “Tier 1” NMS stocks include NMS stocks that form part of the S&P 500 Index, the Russell 1000 Index, and certain exchange-traded products.

<sup>4</sup> Under Rule 4552(c), if two orders are crossed by the ATS, the volume reported would include only the number of shares or par value of bonds crossed as a single trade (e.g., crossing a buy order of 1,000 shares with a sell order of 1,000 shares would be calculated as a single trade of 1,000 shares of volume). FINRA also notes that an ATS should report only one side of a transaction in order to avoid double-counting.

<sup>5</sup> See FINRA Regulatory Notice 14-07, “Alternative Trading Systems” (“Regulatory Notice 14-07”). FINRA Regulatory Notices are available on FINRA’s website, [www.finra.org](http://www.finra.org).

settlement or in any other way inserts itself into a trade (e.g., exchanging securities or funds on behalf of one or both subscribers taking part in the trade).”<sup>6</sup>

#### Use of a Market Participant Identifier (“MPID”)

The SEC concurrently approved amendments to FINRA’s rules relating to the use of Market Participant Identifiers, or MPIDs, that require each broker-dealer operating an ATS to obtain a MPID for each ATS that it operates. The ATS MPID must be used to make the reports required by Rule 4552, and must use the ATS MPID for any other transaction reporting required in respect of such transactions (for example, TRACE reports).

### Summary of ATS Regulation and Corresponding E.U. Regulation

#### Exchange Regulation and the Emergence of ATS

Under the Securities Exchange Act, an “exchange” is defined as

“any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.”<sup>7</sup>

Over time, technology has made it easier for securities market participants, such as broker-dealers, to create automated systems that bring together purchase and sale interest across a wide range of securities and non-securities products. As a result of these technological changes, in 1998, the SEC adopted Regulation ATS and corresponding Rule 3a1-1.<sup>8</sup>

#### Regulation ATS

Rule 300(a) of Regulation ATS defines an ATS as:

(a) [...] any organization, association, person, group of persons, or system:

(1) That constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of § 240.3b-16 of this chapter; and

(2) That does not:

(i) Set rules governing the conduct of subscribers other than the conduct of such subscribers’ trading on such organization, association, person, group of persons, or system; or

(ii) Discipline subscribers other than by exclusion from trading.

<sup>6</sup> See Regulatory Notice 14-07 at page 3.

<sup>7</sup> See Securities Exchange Act Section 3(a)(1). See also Rule 3b-16 under the Securities Exchange Act, which provides interpretive guidance regarding certain components of the definition found in Section 3(a)(1).

<sup>8</sup> Rule 3a1-1 states that an organization that would otherwise come within the definition of an “exchange” will not be required to register with the SEC as an exchange, provided that such organization operates in accordance with Regulation ATS.

Regulation ATS has three basic rules governing ATS activity:

- Rule 301, which requires virtually all ATSs to register as broker-dealers; to file Form ATS with the SEC; to grant execution access to national exchanges; in certain circumstances, to provide fair access to subscribers in accordance with objective access criteria; and, in certain circumstances, to establish and test systems capacity, processing, vulnerability, and disaster recovery standards.
- Rule 302, which creates detailed record-keeping requirements for ATSs.
- Rule 303, which sets the record preservation requirements for ATSs.

#### European Regulation of Multilateral Trading Facilities

In Europe, multilateral trading facilities (MTFs) are regulated under the Markets in Financial Instruments Directive (Directive 2004/39/EC, "MiFID"). The current MiFID imposes various pre-trade and post-trade reporting obligations on users and operators of MTFs in relation to EU listed shares. These include an obligation to make public bid and offer prices advertised through an MTF's systems and to publicly report the price, volume and time of actual transactions. Proposed new rules under MiFID II / MiFIR will extend similar rules to all financial products (subject to exemptions, if granted). The definition of trading systems covered by such requirements will also be extended through the new concept of "organised trading facilities".

#### Conclusion

The adoption of Rule 4552 by FINRA represents a significant increase in the regulatory burdens placed on broker-dealers that operate ATSs. This is due not only to the technological requirements that must be met in order to make the required reports, but also because FINRA will undoubtedly analyze the collected data in a manner similar to its use of trade reporting data—meaning that member firms that make reports of ATS data will receive inquiries from FINRA both regarding the substance of the reports, and regarding any perceived reporting errors that are discovered.

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