

FIA PTG

PRINCIPAL TRADERS GROUP

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September 27, 2022

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Exemption for Certain Exchange Members
Release No. 34-95388; File No. S7-05-15

Dear Ms. Countryman:

The FIA Principal Traders Group (“FIA PTG”)¹ appreciates the opportunity to comment on the Securities and Exchange Commission’s (the “SEC” or “Commission”) proposal to rescind the de minimis allowance and the proprietary trading exclusion (the “Exemption for Certain Exchange Members” or the “Proposal”), which generally would require Association membership for any registered proprietary broker-dealer (“Proprietary BD”) that effects securities transactions elsewhere than on a national securities exchange of which it is a member. If adopted, the Proposal would generally require Proprietary BDs engaged in off-exchange trading, including some FIA PTG member firms, to become members of the Financial Industry Regulatory Authority, Inc. (“FINRA”) (being the sole national securities association).² Additionally, it is important to note that the pending proposal to change the dealer definition³ could require additional non-broker-dealer proprietary trading firms (“PTFs”) to register as Proprietary BDs, and if this Proposal is adopted, they would in turn also be required to become FINRA members.⁴

¹ FIA PTG is an association of firms, many of whom are broker-dealers, who trade their own capital on exchanges in futures, options and equities markets worldwide. FIA PTG members engage in manual, automated and hybrid methods of trading, and they are active in a wide variety of asset classes, including equities, fixed income, foreign exchange and commodities. FIA PTG member firms serve as a critical source of liquidity, allowing those who use the markets, including individual investors, to manage their risks and invest effectively. The presence of competitive professional traders contributing to price discovery and the provision of liquidity is a hallmark of well-functioning markets. FIA PTG advocates for open access to markets, transparency and data-driven policy.

² Alternatively, some Proprietary BDs could decide to change their business models and either: (i) trade solely upon exchanges of which they are members; (ii) cease trading exchange-listed equity securities; or (iii) terminate their registrations as broker-dealers with the SEC.

³ See *File No: S7-12-22* - “Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer,” March 28, 2022.

⁴ Alternatively, some non-broker-dealer PTFs could decide to change their business models including exiting trading U.S. Treasury Securities.

While FIA PTG supports transparent, well-regulated markets, we do not support this Proposal. We believe the costs for firms affected by the Proposal would be substantial (both monetarily and otherwise) and far outweigh the Proposal's limited benefits. We are also concerned that imposing unnecessary costs on Proprietary BDs could force participants out of these markets and further exacerbate existing liquidity challenges. Finally, we believe there may be less burdensome alternatives to accomplish the underlying goals set forth in the Proposal.

1. Perceived Benefits

What problem does adding FINRA membership to the oversight of Proprietary BD business address? It is clear that requiring FINRA membership would impose significant regulatory and compliance-related obligations and associated costs on Proprietary BDs, both initially and on an ongoing basis — what is unclear, is what benefit this would add to the current regulatory framework. Historically FINRA has focused its resources on protecting retail customer activity through regulation and surveillance of broker-dealers with customer facing businesses and left oversight of Proprietary BDs to the exchanges. As referenced in the Proposal, an “overarching principle in the Exchange Act is that the SRO best positioned to conduct regulatory oversight should assume that responsibility.” Currently, Proprietary BDs are regulated by the exchanges of which they are members and by their designated examining authorities (“DEAs”). These self-regulatory organizations (“SROs”) have specific expertise in overseeing Proprietary BDs without customers. In addition to understanding the role these BDs provide to the marketplace, they have designed the exchange rules and infrastructure which administer the way Proprietary BDs interact with the market. This insight makes the SROs well positioned to oversee the activity of Proprietary BDs. The Proposal suggests that FINRA might perform oversight functions better than these SROs or DEAs; however, we fail to see the validity of this argument given the specialized expertise of the existing regulators of Proprietary BDs and the lack of FINRA experience and understanding of PTFs.

Using existing CAT data, FINRA has the ability to surveil 100% of cross-market and off-exchange equity trading activity. Since the implementation of the Consolidated Audit Trail (“CAT”), the gap in off-exchange trade reporting has effectively been closed. Both exchange SROs and FINRA are able to perform cross-market surveillance of trading activity in NMS and OTC securities using CAT data. While access to off-exchange trading activity was a challenge in 2015 when this membership requirement was originally proposed, with the implementation of the CAT, this is no longer the case. The Proposal repeatedly refers to how dramatically different today's market structure is from when Rule 15b9-1 was implemented. FIA PTG asserts that reporting and surveillance capabilities are dramatically different as well, because of the CAT, making the proposed requirement unnecessary.

Expansion of FINRA's direct jurisdiction to include Proprietary BDs would have limited benefit. While the CAT has increased FINRA's access to cross-market and off-exchange trading information with respect to non-FINRA member firms, there remains a concern about FINRA's lack of direct jurisdiction over these firms. FIA PTG acknowledges that requiring FINRA membership would likely have some limited jurisdictional benefit. For example, if FINRA

identified a rule violation by a Proprietary BD that occurred exclusively off-exchange, they would have the jurisdiction to seek disciplinary action or enforcement directly, rather than needing to refer the matter to the FINRA member through which the trade occurred, the SEC, the firm's DEA or an exchange of which the firm is a member. However, it is important to note that the Proposal would only result in FINRA having direct jurisdiction over a relatively small number of Proprietary BDs that trade off-exchange, while continuing to have only indirect jurisdiction over the majority of participants in these off-exchange markets. The very limited expansion of direct jurisdiction does not warrant the costs of FINRA membership for Proprietary BDs.

Is there really a U.S Treasury Securities transaction reporting gap? With respect to PTF transactions, we believe the answer to be “No.” While we acknowledge that access to CAT data does not shed light on firms' U.S. Treasury Securities trading activity or provide exchanges, SROs or FINRA with the ability to monitor that activity, we note that considerable efforts have already been implemented in this regard. Mandatory TRACE⁵ reporting of U.S. Treasury Securities transactions by FINRA registered broker-dealers, which includes all the electronic trading venues, began in 2017.⁶ Enhanced TRACE reporting of U.S. Treasury Securities transactions on ATSS, including identification of non-FINRA members, was approved in 2018.⁷ Additional mandatory TRACE reporting for banks⁸ started September 1, 2022.⁹ FIA PTG believes that these rules capture effectively all PTF U.S. Treasury Securities transactions for regulatory reporting.

We have unsuccessfully tried to ascertain whether there are any known gaps in the reporting of U.S. Treasury Securities transactions executed by PTFs. We are aware of potential identifier concerns around transactions on an ATS that is not a covered ATS, or otherwise than on an ATS, with a counterparty that is also not a FINRA member. In the former case, the transaction still must be reported to TRACE, but the non-FINRA member is not specifically identified via an MPID and instead is identified only as a “customer;” and in the latter case, there is no TRACE reporting obligation whatsoever. We are not aware of either of these situations applying to PTF transactions in any meaningful way. That being said, to the extent that any PTF transactions in U.S. Treasury Securities are not currently being reported to TRACE, FIA PTG supports remedying those gaps and requiring that all PTF transactions in U.S. Treasury Securities be reported with account ownership identifiers on each transaction. We see no need for a FINRA membership requirement to achieve this goal.

⁵ The “Trade Reporting And Compliance Engine,” designed and operated by FINRA, which facilitates the reporting of certain over-the-counter transactions.

⁶ <https://www.finra.org/rules-guidance/notices/trade-reporting-notice-061217>.

⁷ <https://www.sec.gov/rules/sro/finra/2018/34-83815.pdf>

⁸ Every national bank, state member bank, state non-member bank, savings association, or U.S. branch and agency of a foreign bank that files a Notice by Financial Institutions of Government Securities Broker or Government Securities Dealer Activities (Form G-FIN) with average daily transaction volumes over \$100 million (for U.S. Treasury debt) or over \$50 million (for agency-issued debt and mortgage-backed securities) during the 12-month period ending September 30 of the prior year will be subject to the new reporting rules, regardless of the type(s) of trading activity in which such entity engages (*i.e.*, whether dealer or non-dealer activity).

⁹ <https://www.finra.org/filing-reporting/trace/federal-reserve-depository-institution-reporting>.

The assertion that no exchange SRO possesses the expertise or proclivity to exert SRO oversight over their members' US Treasury Securities trading activity, and that instead, FINRA does, is non-sensical. Similar to what we have seen in the equity markets as a result of the CAT, once TRACE reporting is in place, the surveilling of the U.S. Treasury Security trading activity of PTFs can be done equally as effectively by a DEA as it can by FINRA. If the exchanges do not currently have the expertise to provide this oversight, they can acquire it. And as stated previously, they have already developed monitoring programs specifically based on their experience with Proprietary BD members. We see no advantage or perceived benefit to have FINRA perform these functions.

2. Estimated Costs

FIA PTG believes that the costs associated with FINRA membership presently outweigh the perceived benefits. These costs include both one-time and recurring costs for the effected Proprietary BDs including, without limitation: initial membership application, continuing membership applications, TAF fees, registration and examination fees, gross income assessment fees and ongoing audit/examination and reporting requirements.

The potentially most significant impact from a transaction cost perspective is FINRA's Trading Activity Fee ("TAF"). At present, only proprietary transactions executed on a national securities exchange in a member's capacity as an exchange specialist or market maker are excluded from the TAF. As a result, if FIA PTG members and other Proprietary BDs are required to become FINRA members they will incur substantial TAF not previously incurred. Because TAF is a volume dependent calculation, it is very difficult for us to estimate the annual cost, but we would not be surprised if it is greater than \$1,000,000 per year for some firms. We understand that FINRA is considering modifying the assessment methodology applicable to Proprietary BDs which could result in significant savings, but until we know the specifics of the yet-to-be announced new methodology, we are unable to accurately assess or comment on the fee related costs of FINRA membership to FIA PTG members.

We are also concerned about the potentially duplicative costs related to TRACE reporting of U.S. Treasury Securities transactions that are currently already being reported, needing to be reported again by virtue of FINRA membership requirements.

The FINRA membership application process is not a trivial endeavor. Obtaining FINRA membership would require firms to review and analyze the applicability of a vast array of FINRA rules and interpretations that they were previously not subject to — many of which are not relevant to firms without customers. Subjecting firms to FINRA membership and the related costs thereto would simply create another layer of regulation, rules and costs for those firms and subject them to duplicative rules, costs, regulatory examinations and oversight. Contrary to the estimate of six months included in the Proposal, our understanding is that currently the FINRA membership application process may take more than one year from submission of the application to approval. Accordingly, considering the increased number of applications that would potentially need to be processed if this Proposal is approved, we ask the Commission to extend the membership

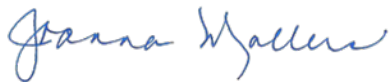
requirement from 360 days total to 360 days for submission of the application and 540 days for approval.

3. Conclusion

FIA PTG recommends the Commission not move forward with this Proposal. We believe the costs could have a significantly negative impact on the activity of Proprietary BDs in both the equity and U.S. Treasury Securities markets at a time when the need for liquidity has never been greater. If you have any questions, or if we can provide further information, please do not hesitate to contact Joanna Mallers at jmallers@fia.org.

Respectfully,

FIA Principal Traders Group

A handwritten signature in blue ink that reads "Joanna Mallers". The signature is cursive and fluid.

Joanna Mallers
Secretary

cc: Gary Gensler, Chair
Hester M. Peirce, Commissioner
Caroline A. Crenshaw, Commissioner
Mark T. Uyeda, Commissioner
Jaime Lizárraga, Commissioner