Non-Tape (or Clearing-Only) Reports

FINRA Adopts Rule Amendments Relating to Non-Tape (or Clearing-Only) Reports for Previously Executed Trades (Including Step-outs, Reversals and Riskless Principal Transactions)

Effective Date: September 4, 2007

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Executive Summary

Effective September 4, 2007, firms will be prohibited from submitting to a FINRA Facility any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to that FINRA Facility, except where such report reflects the offsetting, “riskless” portion of a riskless principal transaction. ¹

Trade reporting rules also were amended to clarify that where the first leg of a riskless principal transaction is reported to FINRA, the second leg must be reported to FINRA; however, in such circumstance, firms are not required to report both legs of the transaction to the same FINRA Facility.


Questions regarding this Notice may be directed to the Legal Section, Market Regulation, at (240) 386-5126; or the Office of General Counsel, at (202) 728-8071.
Background and Discussion

FINRA has amended the trade reporting requirements relating to the submission of non-tape reports (i.e., the transaction is not reported to the tape for publication) and clearing-only reports (i.e., the transaction is not reported to the tape but may be submitted for clearing purposes). As amended, NASD rules prohibit members from submitting to a FINRA Facility (i.e., the Alternative Display Facility, a Trade Reporting Facility (TRF)² or the OTC Reporting Facility) any report (including but not limited to reports of step-outs³ and reversals) associated with a previously executed trade that was not reported to that FINRA Facility.⁴ For example, a clearing-only entry for a step-out relating to a trade executed on and reported through the NASDAQ Exchange cannot be submitted to the FINRA/NASDAQ TRF.

Similarly, firms are not permitted to report a trade to a FINRA Facility for submission to the National Securities Clearing Corporation for clearance and settlement purposes, if the trade was not reported to that same FINRA Facility for public dissemination or regulatory transaction fee assessment purposes. For example, a member cannot tape report a trade to the FINRA/NYSE TRF and use the FINRA/NASDAQ TRF to clear that same trade.

Under the amended rules, there is an exception to this prohibition for reports that reflect the offsetting, “riskless” portion of a riskless principal transaction and members may continue to report such transactions as they do today.⁵ For example, where the initial leg of the transaction is executed on and reported through an exchange, a tape report will not be submitted to FINRA to reflect the initial leg; however, a member may (but is not required to) submit a non-tape (or clearing-only) report for the second leg of the transaction to FINRA. This exception is only available for transactions that meet the definition of “riskless principal” and does not apply to agency transactions.

FINRA also has amended the trade reporting requirements applicable to riskless principal transactions to clarify that where the first leg of the transaction is reported to FINRA, the second leg must also be reported to FINRA; however, in such circumstance, members are not required to report both legs of the transaction to the same FINRA Facility.⁶ As discussed in FINRA’s filing, the current trade reporting rules could have the unintended consequence of requiring members to be participants in all TRFs in order to comply with NASD rules.⁷ FINRA expects that where possible, members will report both legs of a riskless principal transaction to the same FINRA Facility.

The rule change will become operative on Tuesday, September 4, 2007.
Endnotes


2 Currently, there are four TRFs in operation: the FINRA/NASDAQ TRF, the FINRA/NSX TRF, the FINRA/BSE TRF and the FINRA/NYSE TRF.

3 A step-out allows firms to allocate all or part of a previously executed trade to another broker-dealer. In other words, a step-out functions as a position transfer, rather than a trade; the parties are not exchanging shares and funds. The step-out function was designed and implemented to facilitate the clearing process for firms involved in these types of transactions. See, e.g., Notice to Members 05-11 (February 2005) and Notice to Members 98-40 (May 1998).

4 See amendments to NASD Rules 6130 (new paragraph (i)), 6130A (new paragraph (d)), 6130C (new subparagraph (h)), 6130D (new paragraph (h)) and 6130E (new paragraph (h)).

5 For purposes of over-the-counter trade reporting requirements applicable to equity securities, a “riskless principal” transaction is a transaction in which a firm, after having received an order to buy (sell) a security, purchases (sells) the security as principal and satisfies the original order by selling (buying) as principal at the same price (the offsetting, “riskless” leg). A riskless principal transaction can be submitted to FINRA as a single trade report properly marked as riskless principal, or by submitting two separate reports: (1) a report that is submitted to the tape to reflect the initial leg of the transaction and (2) a non-tape (or clearing-only) report to reflect the offsetting, “riskless” leg of the transaction.

6 See amendments to NASD Rules 4632(d), 4632A(e), 4632C(d), 4632D(e) and 4632E(e).

7 For example, assume Firm A is only a participant of TRF A and it executes the first leg of a riskless principal transaction otherwise than on exchange with Firm B, which is only a participant of TRF B. Assume further that Firm B has the reporting obligation under NASD rules. The initial leg of the riskless principal trade will be reported by Firm B to TRF B. Firm A must report the second leg of the riskless principal transaction to FINRA, but because it is not a participant of TRF B, it cannot report the second leg to TRF B. The amended rules allow Firm A to report the second leg of the transaction to TRF A.