SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–98202; File No. S7–05–15]

RIN 3235–AN17

Exemption for Certain Exchange Members

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is adopting amendments to a rule under the Securities Exchange Act of 1934 (''Act'' or ''Exchange Act'') that exempts certain Commission-registered brokers or dealers from membership in a registered national securities association (''Association''). The amendments replace rule provisions that provide an exemption for proprietary trading with narrower exemptions from Association membership for any registered broker or dealer that is a member of a national securities exchange, carries no customer accounts, and effects transactions in securities otherwise than on a national securities exchange of which it is a member. The amendments create exemptions for such a registered broker or dealer that effects securities transactions otherwise than on an exchange of which it is a member that result solely from orders that are routed by a national securities exchange of which it is a member to comply with order protection regulatory requirements, or are solely for the purpose of executing the stock leg of a stock-option order.

DATES:

Effective date: November 6, 2023.

Compliance date: The compliance date is September 6, 2024.

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I. Introduction

On July 29, 2022, the Commission re-proposed amendments to 17 CFR 240.15b9–1 (''Rule 15b9–1'').[1] The Commission is adopting those amendments as re-proposed.

Rule 15b9–1 sets forth an exemption from section 15(b)(8) of the Act pursuant to which a Commission-registered dealer can engage in unlimited proprietary trading of securities on any exchange of which it is not a member or in the off-exchange market (collectively referred to herein as ''off-member-exchange'') without joining an Association, so long as the dealer is a member of a national securities exchange, carries no customer accounts, and its proprietary trading is conducted with or through another registered broker-dealer.[2] The Commission adopted this exemption several decades ago so that an exchange member's limited off-member-exchange proprietary trading activity ancillary to its exchange activity—which, at that time, typically was a floor business conducted on a single national securities exchange—would not necessitate Association membership in addition to exchange membership.[3]

The adopted amendments update Rule 15b9–1 by rescinding the proprietary trading exemption from the rule such that, subject to two narrow exemptions, Commission-registered broker-dealers that effect off-member-exchange securities transactions must comply with section 15(b)(8) of the Act by joining an Association. The amended rule's two exemptions apply when a broker or dealer that does not carry customer accounts and is a member of at least one exchange effects off-member-exchange securities transactions that: (1) result solely from orders that are routed by an exchange of which the broker or dealer is a member in order to comply with 17 CFR 242.611 (Rule 611 of Regulation NMS) or the Options Order Protection and Locked/Crossed Market Plan;[4] or (2) are solely for the purpose of executing the stock leg of a stock-option order.[5]

In the decades since the adoption of the proprietary trading exemption, the securities markets have undergone a substantial transformation that has been

[1] *See* Securities Exchange Act Release No. 95388 (July 29, 2022), 87 FR 49930 (Aug. 12, 2022) (''2022 Re-Proposing Release'' or ''2022 Re-Proposal''). The 2022 Re-Proposal re-proposed amendments that the Commission proposed on Mar. 25, 2015. *See* Securities Exchange Act Release No. 74581 (Mar. 25, 2015), 80 FR 18036 (Apr. 2, 2015) (''2015 Proposing Release'' or ''2015 Proposal'').

[2] Section 15(b)(8) of the Act prohibits any registered broker or dealer from effecting transactions in securities unless it is a member of an Association or effects transactions in securities solely on an exchange of which it is a member. Section 15(b)(8) applies to any security other than commercial paper, bankers' acceptances, or commercial bills. 15 U.S.C. 78*o*(b)(8). References herein to ''exchange'' or ''national securities exchange'' are to a national securities exchange that is registered with the Commission pursuant to section 6 of the Act. *See* 17 CFR 240.600(b)(45) (defining ''national securities exchange''). ''Off-exchange'' as used herein means any securities transaction that is covered by section 15(b)(8) of the Act that is not effected, directly or indirectly, on a national securities exchange. Off-exchange trading includes securities transactions that occur through alternative trading systems (''ATSs'') or with another broker or dealer that is not a registered ATS, and is also referred to as over-the-counter (''OTC'') trading.

[3] *See infra* notes 33–34 and accompanying text (discussing the adoption of 17 CFR 240.15b8–1 (''Rule 15b8–1''), which was later renumbered to Rule 15b9–1).

[4] *See* Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (Aug. 6, 2009) (''Options Linkage Plan'').

[5] *See* amended Rule 15b9–1, under ''Text of Amendments,'' *infra*. Consistent with section 15(b)(8) of the Act, and unchanged by the adopted amendments, a broker or dealer is not required to become a member of an Association if the broker or dealer effects securities transactions only on an exchange of which it is a member. *See* section 15(b)(8) of the Act, 15 U.S.C. 78*o*(b)(8).

driven primarily by rapid and ongoing evolution of technologies for generating, routing, and executing orders, and the impact of regulatory changes.[6] Today, little trading in the U.S. securities markets is floor-based and broker-dealer firms no longer trade primarily on a single exchange. Rather, securities trading today is highly automated, substantially more complex, and dispersed among many trading centers including 24 registered exchanges and a myriad off-exchange venues such as ATSs and OTC market makers.[7] Proprietary trading broker-dealer firms have emerged that engage in significant, computer-based or algorithmic, securities trading activity for their own account across the full range of these exchange and off-exchange venues, often at lightning speeds.[8]

Rule 15b9–1 has remained static, however, as these types of firms have emerged and off-member-exchange securities trading has proliferated. As detailed in the 2022 Re-Proposal and section II.B below, several of these firms effect significant off-member-exchange securities transaction volume yet, in reliance on Rule 15b9–1, they are not members of the Financial Industry Regulatory Authority, Inc. (''FINRA''), the only Association currently.[9] Broker-dealers that are not FINRA members are not subject to FINRA's rules or FINRA's direct, membership-based jurisdiction.[10] As a result, when broker-dealer firms that are members of one or more exchanges but not FINRA members effect proprietary off-member-exchange securities transactions,[11] these firms are not subject to FINRA's rules or its membership-based jurisdiction over such activity and are not all subject to the same set of exchange rules and interpretations of those rules, which can vary between exchanges.

Because such exempt firms are not subject to FINRA's direct, membership-based jurisdiction when they engage in off-member-exchange securities trading activity, there is less stability and consistency in the oversight that is applied to such activity than there would be if such firms were Association members. To address this concern, the amendments to Rule 15b9–1 help ensure, as mandated by section 15(b)(8) of the Act, that an Association (currently, FINRA) generally has direct, membership-based oversight over broker-dealers that effect off-member-exchange securities transactions and the jurisdiction to directly enforce their compliance with Federal securities laws, Commission rules, and Association rules. Requiring broker-dealers that engage in off-member-exchange securities transactions to become Association members will provide FINRA with, among other things, the ability to apply with a greater degree of autonomy its expertise in supervising the firms' off-member-exchange securities trading activity and investigating potential misconduct in that market segment. With respect to FINRA members, FINRA can determine whether to pursue examinations and investigations, and the parameters thereof, in a way that it cannot with respect to non-FINRA members.

Some commenters expressed broad support for the 2022 Re-Proposal, while other commenters expressed opposition primarily based on the argument that direct, membership-based FINRA oversight of proprietary trading broker-dealers is unnecessary in light of existing regulatory mechanisms and that the costs of FINRA membership would be unduly burdensome.[12] As discussed in the 2022 Re-Proposal and section III below, direct, membership-based jurisdiction by an Association over broker-dealers that are not FINRA members cannot be achieved through existing self-regulatory organization (''SRO'') oversight mechanisms such as joint SRO plans pursuant to 17 CFR 240.17d–2 (''Rule 17d–2'') [13] or regulatory service agreements (''RSA(s)''),[14] or through reliance on the

[6] *See* Securities Exchange Act Release No. 61358 (Jan. 14, 2010), 75 FR 3594 (Jan. 21, 2010) (Concept Release on Equity Market Structure) (''Equity Market Structure Concept Release''), at 3594 (''Changes in market structure also reflect the markets' response to regulatory actions such as Regulation NMS, adopted in 2005, the Order Handling Rules, adopted in 1996, as well as enforcement actions, such as those addressing anti-competitive behavior by market makers in NASDAQ stocks.'').

[7] *See* 2015 Proposing Release, *supra* note 1, 80 FR 18038; 2022 Re-Proposal, *supra* note 1, 87 FR 49935. *See also* Equity Market Structure Concept Release, *supra* note 6.

[8] Proprietary trading firms that engage in so-called high-frequency trading strategies tend to effect transactions across the full range of exchange and off-exchange markets, including ATSs. They also typically use complex electronic trading strategies and sophisticated technology to generate a large volume of orders and transactions throughout the national market system. *See* 2015 Proposal, *supra* note 1, 80 FR 18038; 2022 Re-Proposal, *supra* note 1, 87 FR 49935–36. Many, but not all, proprietary trading firms are often characterized by: (1) the use of extraordinarily high-speed and sophisticated computer programs for generating, routing, and executing orders; (2) the use of co-location services and individual data feeds offered by exchanges and others to minimize network and other types of latencies; (3) the use of very short time-frames for establishing and liquidating positions; (4) the submission of numerous orders that are cancelled shortly after submission; and (5) ending the trading day in as close to a flat position as possible (that is, not carrying significant, unhedged positions overnight). *See* Equity Market Structure Concept Release, *supra* note 6, 75 FR 3606; *see also* Staff of the Division of Trading and Markets, ''Equity Market Structure Literature Review, Part II: High Frequency Trading,'' at 4–5 (Mar. 18, 2014) (*available at http://www.sec.gov/marketstructure/research/hft_lit_review_march_2014.pdf*). Staff reports, Investor Bulletins, and other staff documents (including those cited herein) represent the views of Commission staff and are not a rule, regulation, or statement of the Commission. The Commission has neither approved nor disapproved the content of these staff documents and, like all staff statements, they have no legal force or effect, do not alter or amend applicable law, and create no new or additional obligations for any person.

[9] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49936–37. *See also* section III, *infra.* The National Futures Association (''NFA''), as specified in section 15A(k) of the Act, also is registered as a national securities association, but only for the limited purpose of regulating the activities of NFA members that are registered as brokers or dealers in security futures products under section 15(b)(11) of the Act.

[10] *See* FINRA Rule 0140.

[11] To be consistent with current Rule 15b9–1's proprietary trading exemption, off-member-exchange securities trading must occur with or through another registered broker-dealer, such as, in the case of trading on an exchange where the firm is not a member, through a broker-dealer that is a member of the exchange. *See* 17 CFR 240.15b9–1(b)(1).

[12] Comments received in response to the 2022 Re-Proposing Release are *available at https://www.sec.gov/comments/s7-05-15/s70515.htm.* The 2022 Re-Proposal re-proposed amendments to Rule 15b9–1 that the Commission proposed in 2015, with certain modifications informed by comments received on the 2015 Proposal, which comments the Commission addressed in the 2022 Re-Proposal. *See* 2015 Proposal, *supra* note 1. Comments received in response to the 2015 Proposing Release are *available at https://www.sec.gov/comments/s7-05-15/s70515.shtml.*

[13] *See* 17 CFR 240.17d–2. With respect to a broker or dealer that is a member of more than one SRO (''common member''), section 17(d)(1) of the Act authorizes the Commission, by rule or order, to relieve an SRO of the responsibility to receive regulatory reports, to examine for and enforce compliance with the applicable statutes, rules, and regulations, or to perform other specified regulatory functions. *See* section 17(d)(1) of the Act, 15 U.S.C. 78q(d)(1). To implement section 17(d)(1), the Commission adopted 17 CFR 240.17d–1 (''Rule 17d–1'') and Rule 17d–2 under the Act. *See* 17 CFR 240.17d–1 and 240.17d–2. Rule 17d–1 authorizes the Commission to name a single SRO as the designated examining authority (''DEA'') to examine common members for compliance with the financial responsibility requirements imposed by the Act, or by Commission or SRO rules. *See* Securities Exchange Act Release No. 12352 (Apr. 20, 1976), 41 FR 18808 (May 7, 1976). To address regulatory duplication in areas other than financial responsibility, including sales practices and trading practices, the Commission adopted Rule 17d–2 under the Act. *See* Securities Exchange Act Release No. 12935 (Oct. 28, 1976), 41 FR 49091 (Nov. 8, 1976). Rule 17d–2 permits SROs to propose joint plans among two or more SROs for the allocation of regulatory responsibility with respect to their common members. 17 CFR 240.17d–2. The regulatory responsibility allocated among SROs only extends to matters for which the SROs would share authority, which means that only common rules among SROs can be allocated under Rule 17d–2. Commission approval of a plan filed pursuant to Rule 17d–2 relieves an SRO of those regulatory responsibilities allocated by the plan to another SRO.

[14] In contrast to Rule 17d–2 plans, RSAs are privately negotiated agreements between two SROs

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Consolidated Audit Trail (''CAT'').[15] Those regulatory measures are useful in many respects but, nevertheless, firms that are not FINRA members remain outside FINRA's direct, membership-based jurisdiction, and FINRA therefore cannot apply its expertise in supervising these firms' off-member-exchange securities trading activity and investigating potential misconduct with the same degree of autonomy that it can for FINRA members.[16]

Moreover, other regulatory developments have heightened the need for Rule 15b9–1 to be updated. In particular, FINRA has established a transaction reporting regime under which broker-dealers that are FINRA members must report U.S. Treasury securities transactions into the Trade Reporting and Compliance Engine (''TRACE'').[17] Some Commission-registered dealer firms that are not FINRA members are significantly involved in trading U.S. Treasury securities proprietarily but are not required to report these transactions since they are not FINRA members (although if the transaction involves a FINRA member, then the FINRA member must report the transaction to TRACE).[18] In addition, U.S. Treasury securities trading occurs entirely off-exchange, thus these non-FINRA members conduct their U.S. Treasury securities trading activities outside of the direct SRO oversight of any exchange and, since they are not FINRA members, outside of FINRA's direct jurisdiction despite the fact that FINRA is the SRO responsible for the off-exchange market.

The rise in electronic proprietary trading and the increasingly fragmented market where trading takes place across many active markets have put pressure on the status quo and persuaded the Commission of the need for there to be more consistent regulation of such trading. Accordingly, after considering the comments received in response to the 2022 Re-Proposal, the Commission is adopting amended Rule 15b9–1 as re-proposed. The Commission continues to believe that oversight of off member-exchange securities trading must be enhanced in light of how securities trading occurs today, by narrowing the extent to which broker-dealer firms can effect off-member-exchange securities transactions—in significant volumes in many cases—while exempt from FINRA membership.

II. Background

A. Regulatory Framework

Broker-dealers generally must register with the Commission and become members of a SRO.[19] Self-regulation is a longstanding, key component of U.S. securities industry regulation.[20] The Exchange Act defines SRO to include each national securities exchange or Association.[21] An SRO sets standards, conducts examinations, and enforces rules regarding its members.[22] In addition to Commission oversight, the Exchange Act requires this layer of SRO oversight, pursuant to which SROs act as front-line regulators of their broker-dealer members.[23] In particular, there are Federal securities laws, Commission rules, and SRO rules that prohibit various forms of improper activity by broker-dealers.[24]

As SROs, exchanges and Associations are required to examine for and enforce compliance by their members and associated persons with the Exchange Act, the rules and regulations thereunder, and the SROs' own rules.[25]

that can expire or be terminated. Under an RSA, one SRO agrees to perform regulatory services on behalf of another SRO in exchange for compensation. Unlike Rule 17d–2 plans, the SRO paying for regulatory services under an RSA retains ultimate legal responsibility for and control over the regulatory functions allocated to the SRO providing the services. There are RSAs between exchange SROs and FINRA, but under these RSAs, for firms that are members of different exchanges but not FINRA members, FINRA applies to such firm's off-member-exchange trading activity the rules of their different member exchanges using the exchanges' interpretations of their rules. *See* Staff of the Division of Trading and Markets, ''Staff Paper on Cross-Market Regulatory Coordination,'' (Dec. 15, 2020) (*available at https://www.sec.gov/tm/staff-paper-cross-market-regulatory-coordination*) (''Cross-Market Regulatory Coordination Staff Paper''). In addition to regulatory coordination that occurs through Rule 17d–2 plans and RSAs, SROs also coordinate regulatory efforts through forums provided by the Intermarket Surveillance Group (''ISG''). *See id.; see also* 2022 Re-Proposal, section II.A.

[15] *See* 17 CFR 242.613; Securities Exchange Act Release No. 79318 (Nov. 15, 2016), 81 FR 84696 (Nov. 23, 2016) (''CAT NMS Plan Approval Order''); notes 90, 107, and 108, *infra,* and accompanying text. *See also* 2022 Re-Proposal, 87 FR 49934, 49939. For proprietary trading broker-dealer firms that become FINRA members due to the amendments to Rule 15b9–1, regulatory coordination mechanisms such as Rule 17d–1 DEA designations and Rule 17d–2 plans would be available to mitigate the potential for duplicative exchange SRO and FINRA oversight.

[16] *See supra* note 14.

[17] *See* FINRA Rule 6700 Series; *see also* Securities Exchange Act Release No. 79116 (Oct. 18, 2016), 81 FR 73167 (Oct. 24, 2016) (File No. SR–FINRA–2016–027). In addition, FINRA requires its members to report all OTC Equity Security and Restricted Equity Security transactions (other than transactions executed on or through an exchange) to FINRA's OTC Reporting Facility (''ORF''). *See* FINRA Rules 6410 and 6610; *see also* FINRA Rules 6420(f) (defining ''OTC Equity Security''); 6420(k) (defining ''Restricted Equity Security''); 6420(n) (defining ''OTC Reporting Facility''). FINRA also requires its members to report off-exchange NMS stock trades to two Trade Reporting Facilities (''TRFs'') that FINRA operates, one jointly with Nasdaq and the other jointly with the NYSE. *See* FINRA Rule 6110 and the FINRA Rule 6000 Series generally; *see also* 17 CFR 242.600(b) (defining ''NMS stock''). Further, FINRA operates the Alternative Display Facility (''ADF'') for NMS stocks, which is a FINRA facility for posting quotes and reporting trades governed by FINRA's trade reporting rules. *See* Securities Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49821 (July 31, 2002) (order approving the ADF); *see also* Securities Exchange Act Release No. 71467 (Feb. 3, 2014), 79 FR 7485 (Feb. 7, 2014) (order approving a proposed rule change to update the rules governing the ADF).

[18] *See* FINRA Rule 6730—Transaction Reporting, Supplementary Material .07—ATS Identification of Non-FINRA Member Counterparties for Transactions in U.S. Treasury Securities.

[19] *See* section 15(a)(1) of the Act, 15 U.S.C. 78*o*(a)(1). For a more detailed background regarding the relevant regulatory environment, including the complementary SRO oversight performed by exchanges and FINRA, *see* 2022 Re-Proposal, *supra* note 1, section II, 87 FR 49932–39; *see also* 2015 Proposal, *supra* note 1, section I, 80 FR 18036–45.

[20] *See* Securities Exchange Act Release No. 50700 (Nov. 18, 2004), 69 FR 71256 (Dec. 8, 2004) (''Concept Release Concerning Self-Regulation'').

[21] *See* section 3(a)(26) of the Act, 15 U.S.C. 78c(a)(26).

[22] *See* Concept Release Concerning Self-Regulation, *supra* note 20 (citing section 15(b)(8) of the Act, 15 U.S.C. 78*o*(b)(8)). Congress historically has favored self-regulation for a variety of reasons, including that effectively regulating the inner-workings of the securities industry at the Federal level was viewed as cost prohibitive and inefficient; the complexity of securities practices made it desirable for SRO regulatory staff to be intimately involved with SRO rulemaking and enforcement; and the SROs could set standards such as just and equitable principles of trade and detailed proscriptive business conduct standards. *Id.* (citing, generally, S. Rep. No. 1455, 73d Cong., 2d Sess. (1934); H.R. Doc. No. 1383, 73d Cong., 2d Sess. (1934); S. Rep. No. 1455, 73d Cong., 2d Sess. (1934)); *see also id.,* 69 FR 71257–58.

[23] Broker-dealers registered with the Commission are subject to the Commission's jurisdiction and oversight and must comply with Commission rules applicable to registered broker-dealers. *See, e.g.,* section 15 of the Act, 15 U.S.C. 78*o*; 17 CFR 240.15a–6 through 240.15b11–1; 17 CFR 240.17a–1 through 240.17a–25. Matters related to SRO actions or their broker-dealer members also may be referred to the Commission or subject to Commission review. *See, e.g.,* sections 19(d), 15 U.S.C. 78(s)(d), and 19(e), 15 U.S.C. 78s(e), of the Act. But the Exchange Act also requires that SROs enforce their members' compliance with the Exchange Act, the rules and regulations thereunder, and the SRO's own rules. *See, e.g.,* sections 6(b)(1), 15 U.S.C. 78f(b)(1); 19(g)(1), 15 U.S.C. 78s(g)(1); and 15A(b)(2), 15 U.S.C. 78*o*–3(b)(2), of the Act; *see also* section 11A(a)(3)(B) of the Act, 15 U.S.C. 78k–1(a)(3)(B) (authorizing the Commission to require SROs to act jointly in planning, developing, operating, or regulating the national market system).

[24] *See, e.g.,* sections 10(b), 15 U.S.C. 78j(b); 15(c), 15 U.S.C. 78*o*(c); and 15(g), 15 U.S.C. 78*o*(g), of the Act; section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); 17 CFR 240.10b–5; FINRA Rules 2020 (Use of Manipulative, Deceptive, or Other Fraudulent Devices), 4530 (Reporting Requirements), 5210 (Publication of Transactions and Quotations); NYSE Rules 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices) and 5220 (Disruptive Quoting and Trading Activity Prohibited); Nasdaq General 9, section 1 (General Standards) and Nasdaq General 9, section 53 (Disruptive Quoting and Trading Activity Prohibited); Cboe Rule 8.6 (Manipulation).

[25] *See* section 19(g) of the Act, 15 U.S.C. 78s(g).

Because of this, SROs that operate an exchange generally possess expertise in supervising members who specialize in trading the products and utilizing the order types that may be unique or specialized within the exchange. This expertise complements the expertise of an Association in supervising its members' cross-exchange and off-exchange securities trading activity. Indeed, the Exchange Act's statutory framework places SRO oversight responsibility with an Association for off-member-exchange securities trading.[26]

Specifically, section 15(b) of the Act provides that Commission registration is generally not effective until the broker-dealer becomes a member of an Association or a national securities exchange if the broker-dealer effects transactions solely on that exchange.[27] Additionally, section 15(b)(8) of the Act prohibits any registered broker or dealer from effecting transactions in securities unless it is a member of an Association or effects transactions in securities solely on an exchange of which it is a member. Section 15(b)(9) of the Act provides the Commission with authority to exempt any broker or dealer from section 15(b)(8), if that exemption is consistent with the public interest and the protection of investors.[28] Rule 15b9–1 sets forth an exemption from section 15(b)(8) of the Act[29] pursuant to authority conferred to the Commission by section 15(b)(9) of the Act.[30]

Rule 15b9–1 provides that any broker or dealer required by section 15(b)(8) of the Act to become a member of an Association shall be exempt from such requirement if it is (1) a member of a national securities exchange, (2) carries no customer accounts, and (3) has annual gross income derived from purchases and sales of securities otherwise than on a national securities exchange of which it is a member in an amount no greater than $1,000 (this $1,000 gross income allowance is referred to herein as the ''*de minimis* allowance'').[31] Under Rule 15b9–1, the *de minimis* allowance does not apply to income derived from transactions for a registered dealer's own account with or through another registered broker or dealer (referred to herein as the ''proprietary trading exclusion'').[32] The Commission adopted the original version of Rule 15b9–1 (then Rule 15b8–1 but generally referred to herein as Rule 15b9–1) in 1965,[33] which included the *de minimis* allowance but not the proprietary trading exclusion; the Commission adopted the proprietary trading exclusion in 1976.[34] Relying on the *de minimis* allowance and proprietary trading exclusion, a registered dealer can remain exempt from Association membership while engaging in unlimited off-member-exchange proprietary trading of securities, so long as the dealer is a member of a national securities exchange, carries no customer accounts, and its proprietary trading is conducted with or through another registered broker-dealer.

B. Updated Background Statistics

The 2022 Re-Proposal set forth statistics regarding off-member-exchange securities trading activity by firms that were Commission-registered broker-dealers and exchange members but not FINRA members during the time periods reviewed by the Commission in the 2022 Re-Proposal.[35] Those statistics are updated below for corresponding year-over-year time periods.[36]

The Commission estimates that, as of the end of September 2022, there were 73 firms that were Commission-registered broker-dealers and exchange members but not FINRA members, and that there were 64 such firms as of April 2023.[37] Many of these firms were members of just one exchange while others were members of multiple exchanges.[38] Specifically, as of April 2023, 22 of the 64 identified firms were single exchange members; 9 of the firms were members of two exchanges; 15 of the firms were members of more than two but 10 or fewer exchanges; and the remainder were members of more than 10 exchanges.[39]

[26] *See* sections 15(b)(8), 15 U.S.C. 78*o*(b)(8); 15A, 15 U.S.C. 78*o*–3; 17(d), 15 U.S.C. 78q(d); and 19(g), 15 U.S.C. 78s(g), of the Act. Under the self-regulatory structure, the SRO where a broker-dealer is registered conducts regulatory oversight and assumes responsibility for that oversight. For example, section 19(g)(1) of the Act, among other things, requires every SRO to examine for and enforce compliance by its members and associated persons with the Act, the rules and regulations thereunder, and the SRO's own rules, unless the SRO is relieved of this responsibility pursuant to section 17(d) or section 19(g)(2) of the Act. *See* sections 17(d), 15 U.S.C. 78q(d); and 19(g)(2), 15 U.S.C. 78s(g)(2), of the Act. Section 17(d)(1) of the Act enables the Commission to allocate authority among SROs when a person is a member of more than one SRO. Section 17(d)(1) of the Act, 15 U.S.C. 78q(d)(1). Section 15A of the Act provides for the creation of national securities associations of broker-dealers, with powers to adopt and enforce rules to regulate the off-exchange market. Section 15A of the Act, 15 U.S.C. 78*o*–3. And as described above, section 15(b)(8) of the Act further implements this construct of effective regulatory oversight by requiring Association membership of a broker-dealer unless it effects transactions solely on an exchange of which it is a member. Section 15(b)(8) of the Act, 15 U.S.C. 78*o*(b)(8).

[27] *See* section 15(b) of the Act, 15 U.S.C. 78*o*(b).

[28] Section 15(b)(9) of the Act, 15 U.S.C. 78*o*(b)(9).

[29] Section 15(b)(8) of the Act, 15 U.S.C. 78*o*(b)(8).

[30] Section 15(b)(9) of the Act, 15 U.S.C. 78*o*(b)(9).

[31] 17 CFR 240.15b9–1(a).

[32] 17 CFR 240.15b9–1(b)(1). Rule 15b9–1 also states that the *de minimis* allowance does not apply to income derived from transactions through the Intermarket Trading System (''ITS''), and defines the term ''Intermarket Trading System'' for purposes of the rule. 17 CFR 240.15b9–1(b)(2) and (c). As discussed below, the Commission proposed to eliminate from amended Rule 15b9–1 references to the ITS because they are obsolete, and the Commission is adopting those eliminations by deleting current paragraphs (b)(2) and (c) from the amended rule. *See infra* note 192 and accompanying text.

[33] The rule was renumbered to Rule 15b9–1 in 1983. *See* SECO Programs; Direct Regulation of Certain Broker-Dealers; Elimination, Securities Exchange Act Release No. 20409 (Nov. 22, 1983), 48 FR 53688 (Nov. 29, 1983) (''SECO Programs Release''). *See also* Qualifications and Fees Relating to Brokers or Dealers Who Are Not Members of National Security [sic] Association, Securities Exchange Act Release No. 7697 (Sept. 7, 1965), 30 FR 11673 (Sept. 11, 1965) (''Qualifications and Fees Release''). The Commission stated in the Qualifications and Fees Release: ''Among the broker-dealers that are not members of a registered national securities association are several specialists and other floor members of national securities exchanges, some of whom introduce accounts to other members. The over-the-counter business of these broker-dealers may be limited to receipt of a portion of the commissions paid on occasional over-the-counter transactions in these introduced accounts, and to certain other transactions incidental to their activities as specialists. In most cases, the income derived from these activities is nominal.'' *Id.* at 11675.

[34] *See* Extension of Temporary Rules 23a–1(T) and 23a–2(T); Adoption of Amendments to SECO Rules, Securities Exchange Act Release No. 12160 (Mar. 3, 1976), 41 FR 10599 (Mar. 12, 1976) (''Adoption of Amendments to SECO Rules''). In adopting the proprietary trading exclusion, the Commission indicated that an exchange floor broker, through another broker or dealer, could effect transactions for its own account on an exchange of which it was not a member. *Id.* at 10600. The Commission stated that such transactions ultimately would be effected by a member of that exchange. In 1983, the Commission further amended Rule 15b9–1 to accommodate transactions effected through the then-new ITS, and eliminated references to, and requirements under, the SECO Program, which was the Commission's program of direct regulation of certain broker-dealers at that time. *See* SECO Programs Release, *supra* note 33.

[35] *See* 2022 Re-Proposal, *supra* note 1, section II, 87 FR 49932–39.

[36] While some updated figures set forth below in this section differ from figures set forth in the 2022 Re-Proposal, the Commission believes that its conclusions are supported by the updated figures as well as the 2022 Re-Proposal's figures.

[37] Sources: SEC FOCUS Reports (Form X–17A–5); FINRA's Central Registration Depository (''CRD'').

[38] Source: CRD.

[39] *Id.* 35 out of the 64 identified firms in April 2023 were members of a Nasdaq group exchange, 34 firms were members of Nasdaq PHLX LLC (''PHLX'') specifically, and five firms were members of only PHLX. The Commission believes these figures are consistent with one commenter's statement in October 2022 that 39 non-FINRA firms were Nasdaq members, 13 of which designated PHLX as their DEA, as minor differences in the Commission's and the commenter's figures could be explained by changes in firms' Nasdaq membership or Commission registration status during the passage of time between October 2022 and April 2023. *See* letter from Erik Wittman, Deputy Head

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Several of these firms—both single-exchange and multiple-exchange members—engage in cross-market and off-exchange proprietary securities trading. These firms account for a significant portion of off-exchange securities trading volume and initiate a significant number of securities transactions on exchanges other than exchanges to which they belong as a member.[40] They forgo FINRA membership presumably in reliance on Rule 15b9–1, as their effectuation of transactions in securities elsewhere than on exchanges to which they belong as a member would trigger section 15(b)(8)'s Association membership requirement but for the exemption provided by Rule 15b9–1.

For example, of the estimated 73 broker-dealers that were exchange members but not FINRA members as of the end of September 2022, 53 initiated orders in listed equities in September 2022 that were executed on or off an exchange.[41] These firms' September 2022 off-exchange listed equities dollar volume executed was approximately $440 billion,[42] which was approximately 5.1% of total off-exchange volume of listed equities executed that month.[43] Moreover, these firms' September 2022 listed equities dollar volume executed on exchanges of which they are not a member was approximately $311 billion.[44]

Of the estimated 64 broker-dealers that were exchange members but not FINRA members as of April 2023, 45 initiated orders in listed equities in April 2023 that were executed on or off an exchange.[45] These firms' April 2023 off-exchange listed equities dollar volume executed was approximately $405 billion,[46] which was approximately 5.6% of total off-exchange volume of listed equities executed that month.[47] Moreover, these firms' April 2023 listed equities dollar volume executed on exchanges of which they are not a member was approximately $262 billion.[48]

A subset of the identified firms that traded during September 2022 and April 2023 accounted for the large majority of the identified firms' aggregate trading volume. In this regard, the Commission estimates that, as of September 2022, 12 of the 53 identified firms that initiated orders in listed equities accounted for approximately 4.5% of total off-exchange listed equities volume executed in September 2022 and 89% of the off-exchange listed equities transaction volume attributable to the 53 identified firms that month.[49] One of the 12 firms initiated $180 billion in off-exchange listed equities executions in September 2022, which was over 2% of total off-exchange listed equities transaction volume that month and approximately one-half of the off-exchange volume executions attributable to the 53 identified firms.[50] With respect to the 53 firms' listed equities transaction volume on exchanges of which they are not a member, one firm accounted for approximately 66% of the $311 billion in volume attributable to the 53 identified firms in September 2022; six firms (including the aforementioned one) accounted for over 90% of that volume; and 22 firms (including the aforementioned six firms) accounted for over 99% of that volume.[51]

The Commission also estimates that, as of April 2023, 12 of the 45 identified firms that initiated orders in listed equities then accounted for approximately 5.1% of total off-exchange listed equities volume executed in April 2023 and 90% of the off-exchange listed equities transaction volume attributable to the 45 identified firms that month.[52] One of the 12 firms initiated $222 billion in off-exchange listed equities executions in April 2023, which was 3.1% of total off-exchange listed equities transaction volume that month and approximately 55% of the off-exchange volume executions attributable to the 45 identified firms.[53] With respect to the 45 firms' listed equities transaction volume on exchanges of which they are not a member, one firm accounted for approximately 72% of the $262 billion in volume attributable to the 45 identified firms in April 2023; five firms (including the aforementioned one) accounted for over 90% of that volume; and 21 firms (including the aforementioned six firms) accounted for approximately 99% of that volume.[54]

With respect to trading in U.S. Treasury securities, all of which occurs off-exchange,[55] the Commission estimates that seven broker-dealers that were exchange members but not FINRA members accounted for over $6 trillion in U.S. Treasury securities volume executed on ''covered ATSs'' in 2022 that was reported to TRACE,[56] which was approximately 3.67% of total U.S Treasury securities volume traded in 2022 that was reported to TRACE.[57] In

of Enforcement, The Nasdaq Stock Market LLC (Oct. 6, 2022) (''Nasdaq Letter'') at 4.

[40] Source: CAT.

[41] *Id.* A firm ''initiating'' an order is the firm that reports the origination of the order as a New Order Event (MENO) to the CAT. The other 20 firms did not initiate orders in listed equities in Sept. 2022.

[42] *Id.* Dollar volumes set forth in this section represent the sum of bought and sold volume during the specified time period.

[43] *Id.* The Commission estimates that there was approximately $8.6 trillion in total off-exchange transaction volume in listed equities reported by buying and selling firms in Sept. 2022.

[44] *Id.* The Commission also estimates that, in 2022, 48 of the 73 firms identified as registered broker-dealers and exchange members but not FINRA members initiated options order executions accounting for approximately 16–27% of daily options contract volume traded. The Commission further estimates that 35 of these 48 firms initiated executions on an exchange where they are not a member, and that this transaction volume represented approximately 3% of these 35 firms' total options contract transaction volume reported in 2022, and approximately 1% of all options contract transaction volume reported in 2022. *Id.* These figures, like the other figures set forth herein, have been updated from what was set forth in the 2022 Re-Proposal.

[45] *Id.* The other 19 firms did not initiate orders in listed equities in Apr. 2023.

[46] *Id.*

[47] *Id.* The Commission estimates that there was approximately $7.2 trillion in total off-exchange transaction volume in listed equities reported by buying and selling firms in Apr. 2023.

[48] *Id. See also* Tables 1 and 2, section V.A.1, *infra,* for additional detail regarding these firms' trading activity during the noted time periods.

[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] *Id.*

[55] *See* U.S. Dep't of the Treasury et al., Joint Staff Report: The U.S. Treasury Market on Oct. 15, 2014 (July 13, 2015) (''Joint Staff Report'') at 2. The secondary market for U.S. Treasury securities (sometimes referred to as the U.S. Treasury cash market) is generally bifurcated between the dealer-to-customer market and the interdealer market. Trading in the U.S. Treasury securities dealer-to-customer market is generally conducted through bilateral transactions. Trading often occurs either over the phone or on trading venues that facilitate the matching of buy and sell orders through electronic systems. In the interdealer market, the majority of trading in on-the-run U.S. Treasury securities currently occurs on ATSs using electronic central limit order books. For off-the-run U.S. Treasury securities, the majority of interdealer trading occurs via bilateral transactions through voice-assisted brokers and electronic trading platforms. *See* Securities Exchange Act Release No. 90019 (Sept. 28, 2020), 85 FR 87106, 87108 (Dec. 21, 2020). On-the-run U.S. Treasury securities are the most recently issued U.S Treasury securities of a particular maturity. Off-the-run U.S. Treasury securities include all U.S. Treasury securities that have been issued before the most recent issuance and are still outstanding.

[56] *See* FINRA Rule 6730(a)(1) (requiring FINRA members to report transactions in TRACE-Eligible Securities, including U.S. Treasury securities).

[57] *See* FINRA Rule 6730—Transaction Reporting, Supplementary Material .07—ATS Identification of Non-FINRA Member Counterparties for Transactions in U.S. Treasury Securities (among other things, defining the term ''covered ATS'' as an ATS that executed transactions in U.S. Treasury securities against non-FINRA member subscribers of $10 billion or more in monthly par value, computed by aggregating buy and sell transactions, for any two months in the preceding calendar quarter). U.S. Treasury securities market share is calculated as the sum of the identified entities' buy and sell volume divided by twice the market-wide volume for the period. Approximately $165 trillion total U.S. Treasury securities transaction volume was reported to TRACE in 2022, of which approximately $64 trillion was reported as executed

April 2023, the Commission estimates that five broker-dealers that were exchange members but not FINRA members accounted for approximately $302 billion in U.S. Treasury securities volume executed on covered ATSs that was reported to TRACE,[58] which was approximately 2.65% of total U.S Treasury securities volume traded in April 2023 that was reported to TRACE.[59]

III. Discussion of Amendments to Rule 15b9–1

Under the amendments to Rule 15b9–1 being adopted, a broker or dealer registered with the Commission pursuant to section 15 of the Act will be required by section 15(b)(8) of the Act to join an Association if the broker or dealer effects off-member-exchange securities transactions, unless it can rely upon one of the amended rule's narrow exemptions.[60] Conversely, and unchanged by these amendments, a broker or dealer will not be required to become a member of an Association if it effects securities transactions only on an exchange of which it is a member.[61]

Specifically, Rule 15b9–1, as amended, no longer provides a *de minimis* allowance or proprietary trading exclusion, and allows an exemption from Association membership only for a registered broker or dealer that is an exchange member, carries no customer accounts, and effects securities transactions solely on a national securities exchange of which it is a member except in two narrow circumstances: (1) a broker or dealer effects off-member-exchange securities transactions that result solely from orders that are routed by an exchange of which it is a member in order to comply with Rule 611 of Regulation NMS or the Options Order Protection and Locked/Crossed Market Plan; or (2) a broker or dealer effects off-member-exchange securities transactions that are solely for the purpose of executing the stock leg of a stock-option order.[62] In the subsections below, the Commission discusses each element of the amended rule in detail.

A. Elimination of the De Minimis Allowance and Proprietary Trading Exclusion

The adopted amendments to Rule 15b9–1 eliminate the *de minimis* allowance and proprietary trading exclusion. Rescinding these provisions generally eliminates (subject to the exemptions in the amended rule) the ability for proprietary trading dealer firms to rely on Rule 15b9–1 to effect off-member-exchange securities transactions without joining an Association. The Commission proposed these rescissions to update Rule 15b9–1 so that it more appropriately effectuates Exchange Act principles of complementary exchange SRO and Association oversight in today's market, including section 15(b)(9)'s mandate that any exemption from section 15(b)(8) be consistent with the public interest and protection of investors.[63]

Some commenters on the 2022 Re-Proposal broadly agreed that Rule 15b9–1 should be updated in this way.[64] They stated that the proposed amendments are appropriate and necessary to modify and modernize Rule 15b9–1 such that it is consistent with the protection of investors and the public interest in today's market.[65] They also stated that the current regulatory framework, which includes RSAs, Rule 17d–2 plans, and the CAT, among other things, does not provide the full scope of regulatory coverage appropriate for comprehensive and consistent oversight of proprietary trading activities because an Association still lacks regulatory jurisdiction over certain trading activity.[66] FINRA stated that performing regulatory work with respect to broker-dealer firms that are not FINRA members pursuant to RSAs is less certain and stable than direct Association oversight of such firms because of the discretionary nature of RSAs.[67] FINRA also emphasized that access to audit trail data does not confer jurisdiction to FINRA over such firms, and that FINRA does not have the independent ability to examine for, investigate, or enforce potential violations of the Federal securities laws or FINRA rules with respect to such firms when they are identified through surveillance or other means.[68] FINRA stated that jurisdictional limitations impede comprehensive off-exchange and cross-market oversight in equities, options, and fixed income markets.[69] Another commenter stated that the proposal would help ensure that high-frequency trading firms, which trade large volumes of equities and U.S. Treasury securities across and off exchanges without being required to join an Association, *i.e.,* FINRA, are subject to consistent and robust oversight through FINRA as opposed to only being subject to complying with the more narrow regulatory requirements specific to each exchange, and that such firms do not take advantage of exclusions provided by Rule 15b9–1 that were intended to accommodate limited broker-dealer activities.[70]

Other commenters questioned the necessity and appropriateness of the application of FINRA oversight to proprietary trading broker-dealer firms that are not FINRA members. They stated that, in light of existing regulatory mechanisms that apply to such firms, including, in particular, proprietary options trading firms, FINRA membership for such firms would be unnecessary and duplicative.[71] In this

on a covered ATS. Beginning in September 2022, a new form of trade reports from depository institutions were added to TRACE. These transactions, which amounted to $4.5 trillion, are excluded.

[58] *See supra* note 56.

[59] *Id.* One broker-dealer that was not a FINRA member and traded U.S. Treasury securities in 2022 joined FINRA prior to April 2023, and another broker-dealer that was not a FINRA member and traded U.S. Treasury securities in 2022 did not appear to trade U.S. Treasury securities in April 2023.

[60] *See* section 15(b)(8) of the Act, 15 U.S.C. 78*o*(b)(8); amended Rule 15b9–1, *infra.*

[61] *See* section 15(b)(8) of the Act, 15 U.S.C. 78*o*(b)(8).

[62] *See* amended Rule 15b9–1, under ''Text of Amendments,'' *infra.*

[63] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49932.

[64] *See* letters from: Marcia E. Asquith, Corporate Secretary, EVP, Board of External Relations, FINRA (Sept. 27, 2022) (''FINRA Letter'') at 1–2; Stephen W. Hall, Legal Director and Securities Specialist, and Scott Farmin, Legal Counsel, Better Markets, Inc. (Sept. 27, 2022) (''Better Markets Letter'') at 6–7.

[65] *See* FINRA Letter at 1–2; Better Markets Letter at 6–7; letter from Henry M. Phillip (Aug. 1, 2022) (''Phillip Letter''). *See also* Nasdaq Letter at 2 (expressing support for broker-dealers being required to join an Association if they effect securities transactions off-exchange and/or in the fixed income space).

[66] *See, e.g.,* FINRA Letter at 5; memorandum dated June 20, 2023, regarding a call between Commission staff and FINRA (''6/20/23 Meeting Memorandum'') (stating that FINRA identified non-FINRA member broker-dealer firms as potential respondents in 5% of the market regulation investigations it conducted in 2020 and 2021, which ranged across asset types and included both cross-exchange and off-exchange conduct).

[67] *See* FINRA Letter at 6.

[68] *Id.*

[69] *Id.*

[70] *See* Better Markets Letter at 5, 7–8; *see also* note 8, *supra,* for a description of high-frequency trading firms. This commenter also stated that high-frequency trading represents roughly 50% of the trading volume in U.S. equities markets and 48% of the total U.S. Treasury securities interdealer market, and that recent liquidity crises in both the U.S. equities and Treasury securities markets have shown the effects on markets dominated by, and heavily reliant on, high-frequency trading firms. *See* Better Markets Letter at 3.

[71] *See, e.g.,* Nasdaq Letter at 3; and letters from: John Kinahan, CEO, Group One Trading, LP (Sept. 26, 2022) (''Group One Letter) at 1–2; Tom Simpson, CEO, PEAK6 Capital Management LLC (Sept. 26, 2022) (''PEAK6 Letter'') at 2; Akuna Securities LLC, Belvedere Trading, Chicago Trading Company, and Volant Trading (Sept. 27, 2022) (''ABCV Letter'') at 3; Angelo Evangelou, Chief Policy Officer, and Greg Hoogasian, Chief Regulatory Officer, Cboe Global Markets, Inc. (Sept. 27, 2022) (''Cboe Letter'') at 4–7; Kirsten Wegner,

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regard, they stated that exchange SROs, including where appointed as DEA over certain of their members, already possess and exercise authority and can cooperate on regulatory matters to ensure compliance with the securities laws.[72] They also stated that the CAT provides exchanges with sufficient visibility into proprietary broker-dealers' off-member-exchange securities trading activity, which, they contended, obviates the need for proprietary trading broker-dealers to be required to join FINRA.[73]

As explained below in this section, the Commission continues to believe that, in today's market, the *de minimis* allowance and proprietary trading exclusion must be eliminated from Rule 15b9–1 such that there is direct, membership-based Association SRO oversight of broker-dealers' off-member-exchange securities trading activity, in accordance with section 15(b)(8) of the Act and with the section 15(b)(9) requirement that any exemption from section 15(b)(8) be consistent with the protection of investors and the public interest.[74]

Requiring broker-dealers that engage in off-member-exchange securities transactions to become FINRA members will provide FINRA with direct jurisdiction and the ability to apply with a greater degree of autonomy its expertise to the firms' off-member-exchange securities trading activity and investigate potential misconduct in that market segment. With respect to FINRA members, FINRA can determine whether to pursue examinations and investigations, and the parameters thereof, in a way that it cannot with respect to non-FINRA members, as FINRA's oversight over the latter depends on RSA arrangements, pursuant to which exchange SROs retain legal responsibility and final decision-making authority with respect to the covered exchange members.[75] In contrast, for FINRA member broker-dealer firms that effect off-member-exchange securities transactions, FINRA possesses legal responsibility and decision-making authority with respect to exercising SRO oversight because FINRA can directly apply its own jurisdiction and rules to such firms. As such, FINRA can unilaterally decide whether and how to examine and investigate off-member-exchange activity by a FINRA member firm for compliance with FINRA rules, and what course of action to pursue if potential FINRA rule violations are identified.

Moreover, due to FINRA's experience and expertise in cross-market and off-exchange oversight, FINRA is well-positioned to perform direct, membership-based oversight over broker-dealer firms that effect off-member-exchange securities transactions, as FINRA could bring such broker-dealers within the applicable regulatory operations that FINRA already has in place for its direct oversight of FINRA members that trade across markets. And this FINRA oversight extends to U.S. Treasury securities trading activity, unlike RSA-based SRO oversight, which does not extend to such activity.[76]

While FINRA traditionally has been the SRO that primarily oversees off-member-exchange securities trading activity, in the context relevant here—proprietary trading broker-dealer firms with exchange-only SRO membership that effect off-member-exchange securities transactions—FINRA is unable to directly enforce such firms' compliance with Federal securities laws and Commission rules applicable to broker-dealers, or apply its own rules to such firms, because they are not FINRA members. Without direct, membership-based FINRA oversight, SRO oversight of such firms' off-member-exchange securities trading activity is largely a function of cooperative regulatory arrangements among SROs, but those arrangements do not confer membership-based jurisdiction to FINRA to enforce compliance with the Exchange Act and applicable rules. These arrangements include those discussed in the 2022 Re-Proposal and highlighted by commenters, such as exchange SRO oversight through being appointed as DEA for certain exchange members pursuant to Rule 17d–1 and through Rule 17d–2 plans, indirect FINRA oversight pursuant to RSAs with exchange SROs, and the CAT.[77] As discussed below in this section, while these arrangements serve useful purposes and enhance regulatory outcomes, the Commission continues to believe that, in today's market, they are inadequate substitutes for direct, membership-based FINRA jurisdiction over firms that effect off-member-exchange securities transactions.

Commenters described the general proficiency of direct exchange SRO oversight over exchange members.[78] As

CEO, Modern Markets Initiative (Sept. 27, 2022) (''MMI Letter'') at 2; Thomas M. Merritt, Deputy General Counsel, Virtu Financial, Inc. (Sept. 30, 2022) (''Virtu Letter'') at 2–3; Joanna Mallers, Secretary, FIA Principal Traders Group (Sept. 27, 2022) (''FIA PTG Letter''), at 4. *See also* letter from Chasse R. Thomas (Sept. 26, 2022) (''Thomas Letter'') at 2 (stating that the proposal should not be adopted because FINRA's ability to monitor complex financial market is inefficient and unreliable). Some commenters also stated that the FINRA membership application process requires information that is duplicative of information already provided to the Commission and other SROs. *See* PEAK6 Letter at 2; FIA PTG Letter at 4. The Commission does not believe that the submission of information in connection with the FINRA membership application process that is duplicative of information already provided to the Commission or exchange SROs is a reason to forgo the amendments to Rule 15b9–1 being adopted. To the extent information requested by FINRA is duplicative, firms may be able to leverage their prior submissions when applying for FINRA membership. Moreover, it is important that each SRO of which a broker-dealer is a member, including FINRA, have the requisite information required by its membership application, regardless of any duplication of the information, because each SRO has regulatory responsibilities over the broker-dealer. FINRA may require the same information that is provided to exchange SROs so that it may be able to review the information in order to approve the membership application and effectively regulate the firm. Additionally, Commission-registered broker-dealers that are exchange members and that join FINRA as result of these rule amendments would not be situated any differently from the many Commission-registered broker-dealers that are exchange members and already FINRA members. In addition, *see* discussion below in this section as well as in section V, *infra,* regarding FINRA membership costs for broker-dealer firms that must join FINRA as a result of the adopted amendments.

[72] *See, e.g.,* Group One Letter at 1–2; PEAK6 Letter at 2; ABCV Letter at 3; Cboe Letter at 4–7; Nasdaq Letter at 3; FIA PTG Letter at 4; MMI Letter at 2; Virtu Letter at 2–3.

[73] *See, e.g.,* MMI Letter at 2; FIA PTG Letter at 2; Cboe Letter at 2–3; STA Letter at 2–3; ABCV Letter at 3; PEAK6 Letter at 3; Group One Letter at 2; letter from Eric Chern, Co-Founder, Chicago Trading Company, LLC (Sept. 27. 2022) (''CTC Letter'') at 4.

[74] Commenters' critiques of the 2022 Re-Proposal are largely the same as those that the Commission received in response to the 2015 Proposal, and the Commission continues to disagree with them for many of the same reasons expressed in the 2022 Re-Proposal. *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49941.

[75] *See supra* note 14.

[76] *See* FINRA Letter at 8. FINRA has taken an active role in overseeing trading activity in U.S. Treasury securities by, for example, requiring U.S. Treasury securities to be reported to TRACE, and by publishing daily files of aggregated U.S. Treasury securities transactions data reported to TRACE. *See* FINRA Rules 6730 and 6750; *see also* Treasury Daily Aggregate Statistics, available at *https://www.finra.org/finra-data/browse-catalog/about-treasury/daily-file.* In addition, FINRA has taken enforcement action regarding U.S. Treasury securities trading activity and reporting. *See, e.g., FINRA Department of Enforcement* v. *BGC Financial, L.P.,* FINRA Letter of Acceptance, Waiver, and Consent No. 2020068558701 (Jan. 20, 2023), *available at https://www.finra.org/sites/default/files/fda_documents/2020068558701%20BGC%20Financial%2C%20L.P.%20CRD%2019801%20AWC%20va%20%282023-1676852400276%29.pdf.*

[77] *See* CAT NMS Plan Approval Order, *supra* note 15, 81 FR 84836–41, for a discussion of the benefits provided to SROs by the CAT with regard to surveillance, examinations, enforcement investigations, and tips and complaints.

[78] *See* Nasdaq Letter at 2 (citing traditional operational responsibilities such as real-time surveillance, and the establishment of an investigation and enforcement team in 2017 dedicated to prosecuting member misconduct on its equities and options markets); Cboe Letter at 6 (stating that SROs operate comprehensive in-house regulatory programs which include cross market surveillance, such as CAT).

discussed in the 2022 Re-Proposal, in contrast to FINRA, the regulatory focus of exchange SROs is generally on trading by their members on their respective exchanges.[79] Exchange SROs generally monitor market activity specific to their own exchanges and have expertise in regulating unique aspects of their markets.[80] The focus of the amendments being adopted here, however, is different. Here, the Commission is concerned with off-member-exchange securities trading activity, SRO oversight of which traditionally has been and remains primarily FINRA's responsibility. As discussed above and in the 2022 Re-Proposal, several broker-dealer firms that are exchange members but not FINRA members effect off-member-exchange securities transactions.[81] This includes firms that trade options proprietarily and are engaged in proprietary options market making. While some commenters stated that membership-based FINRA oversight over such firms would be unnecessary and would duplicate existing exchange SRO oversight, the Commission continues to believe that direct, membership-based FINRA oversight over these firms (and therefore the amendments being adopted here) is necessary because they effect securities transactions off-member-exchange and thus generally outside the expertise of any exchange where they are a member and within FINRA's primary area of expertise.

Moreover, the Exchange Act provides a way to help address commenter concerns regarding regulatory duplication. Specifically, with respect to common members, section 17(d) of the Act authorizes the Commission to relieve an SRO of the responsibility to receive regulatory reports; to examine for and enforce compliance with applicable statutes, rules, and regulations; or to perform other specified regulatory functions.[82] Section 17(j)(1) of the Act also requires the SROs' cooperation and coordination of broker-dealer examination and oversight activities and elimination of any unnecessary and burdensome duplication in the examination process.[83]

To implement section 17(d)(1) of the Act, the Commission adopted two rules thereunder: Rule 17d–1 and Rule 17d–2. Rule 17d–1 authorizes the Commission to name a single SRO as the DEA to examine a common SRO member (*i.e.,* a broker-dealer that is a member of the DEA SRO as well as other SROs) for compliance with the financial responsibility requirements imposed by the Act, Commission rules, or the rules of the SROs where the broker-dealer is a member.[84] When an SRO has been named as a common member's DEA, all other SROs to which the common member belongs are relieved of the responsibility to examine the firm for compliance with the applicable financial responsibility rules. Rule 17d–1 addresses only an SRO's obligations to enforce member compliance with financial responsibility requirements. Rule 17d–1 does not relieve an SRO from its obligation to examine a common member for compliance with its own rules and provisions of the Federal securities laws governing matters other than financial responsibility, including sales practices and trading activities and practices.

To further address regulatory duplication, the Commission also adopted Rule 17d–2 under the Act. Rule 17d–2 permits SROs to propose joint plans for the allocation of regulatory responsibilities with respect to their common members. Commission approval of a plan filed pursuant to Rule 17d–2 relieves an SRO of those regulatory responsibilities allocated by the plan to another SRO. FINRA has experience coordinating with exchanges in the oversight of broker-dealers that are common members of FINRA and the exchanges on which they trade securities pursuant to such plans.[85] Such coordination among FINRA and exchange SROs pursuant to Rule 17d–2 plans cannot occur, however, with respect to broker-dealer firms that are not FINRA members.[86]

Rule 17d–1 DEA arrangements and Rule 17d–2 plans are relevant with respect to commenters' concern that direct, membership-based FINRA oversight of broker-dealer firms would duplicate exchange SRO oversight.[87] Mitigating duplicative SRO oversight is the primary purpose of these regulatory arrangements.[88] To the extent broker-dealer firms join FINRA as a result of the amendments to Rule 15b9–1 [89] and are members of one or more exchanges, Rule 17d–1 could be utilized to mitigate duplicative oversight with respect to financial responsibility by exchange SROs and FINRA over these common members. And Rule 17d–2 plans could similarly be utilized by exchange SROs and FINRA to mitigate the potential for duplicative SRO oversight over their common members in areas other than financial responsibility. This is what occurs today with common SRO members, and therefore the Commission believes the same will likely occur for proprietary trading broker-dealer firms that are exchange members and newly join FINRA as a result of these amendments.[90]

FINRA has entered into RSAs with certain exchange SROs, which allow for some SRO oversight of off-member-exchange equities and options trading activity by proprietary trading broker-dealer firms that are exchange members

[79] *See* 2022 Re-Proposal, *supra* note 1, 87 at 49934 n. 46.

[80] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49934; Cross-Market Regulatory Coordination Staff Paper, *supra* note 14. *See also* Cboe Letter at 4 (stating that the exchanges know their markets best, including the products traded, the intricacies of the trading mechanics, and their members' business models).

[81] *See supra* section II.B; *see also* 2022 Re-Proposal, *supra* note 1, 87 FR 49935–40.

[82] Section 17(d) of the Act, 15 U.S.C. 78q(d).

[83] Section 17(j)(1) of the Act, 15 U.S.C. 78q(j)(1).

[84] 17 CFR 240.17d–1. *See supra* note 13; *see also* 2022 Re-Proposal, *supra* note 1, 87 FR 49933; Securities Exchange Act Release No. 12352 (Apr. 20, 1976), 41 FR 18808 (May 7, 1976).

[85] *See* Staff Paper on Cross-Market Regulatory Coordination, *supra* note 14.

[86] RSAs are mechanisms through which such coordination can occur, but they are subject to limitations including that they do not relieve the contracting SRO of its legal responsibilities to provide SRO oversight or provide FINRA with jurisdiction. *See supra* note 14 and the discussion *infra* in this section.

[87] *See supra* note 13. *See also* Group One Letter at 3 (stating that the Commission should ensure that FINRA serves as the DEA for options market making firms that newly join FINRA as a result of the amendments to Rule 15b9–1 so that these firms do not pay DEA fees that are duplicative of their current DEA fees paid to an exchange).

[88] *See* Securities Exchange Act Release No. 12935 (Oct. 28, 1976), 41 FR 49091 (Nov. 8, 1976); *see also* note 13, *supra.*

[89] *See infra* sections V.B.1 and V.C.2.d (discussing firms' options for complying with the amendments, and that a firm may choose to join additional exchanges rather than FINRA when the costs of joining FINRA exceed the costs of joining additional exchanges to cover all of the exchanges on which the firm currently trades).

[90] Generally, FINRA is the DEA for financial responsibility rules for exchange members that also are members of FINRA. *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49935 n. 55; *see also* Cross-Market Regulatory Coordination Staff Paper, *supra* note 14 (stating that ''FINRA serves as the Designated Regulation NMS Examining Authority ('DREA') and Designated CAT Surveillance Authority ('DCSA') for common exchange members that are also members of FINRA, and assumes certain examination and enforcement responsibilities for those members with respect to specified Regulation NMS rules (*i.e.,* 606, 607, 611, 612 and 613(g)(2)), and for the cross-market surveillance, examination, investigation and enforcement of Rule 613 and the rules of the SROs regarding compliance with the CAT NMS Plan''). Some exchanges serve as DEA for certain of their members, but these cases mostly involve firms that have specialized business models that focus on a particular exchange that is judged to be best situated to supervise the member firm's activity. *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49956 and n. 228.

but not FINRA members.[91] RSAs can serve useful purposes, but they generally are not publicly available and are not subject to Commission approval. Rather, they are voluntary private agreements between SROs that are not mandated by any Commission rule or statutory obligation, and that may expire or be terminated by the parties. As a result, to the extent oversight is performed on non-FINRA member firms' off-member-exchange securities trading activity based on RSAs, such oversight relies upon discretionary arrangements between exchanges and FINRA insofar as equities and options are concerned; and such agreements to date have not covered U.S. Treasury securities trading activity.[92] In addition, under an RSA, FINRA examines for compliance with the rules of the exchange with which it has entered into the RSA.[93] Thus, non-FINRA members that are members of different exchanges may be subject to different exchange rules and interpretations when they effect off-member-exchange securities transactions to the extent these rules and interpretations are different. This approach provides the potential for a less stable and consistent regulatory regime for the covered off-member-exchange securities transactions than one in which Association membership and oversight is mandated.[94] Moreover, there is no regulatory requirement that any RSA pursuant to which FINRA oversight currently is applied to a non-FINRA member broker-dealer's off-member-exchange securities trading activity must continue to exist.[95]

One commenter stated that firms still will be subject to multiple sets of rules and interpretations if amended Rule 15b9–1 is adopted as re-proposed, and that it will be important for FINRA to continue to work collaboratively as part of the Cross-Market Regulation Working Group (''CMRWG''), a subgroup of the ISG.[96] The ISG was established in 1981 and is an international group of exchanges, market centers, and market regulators that perform front-line market surveillance in their respective jurisdictions. The group was formed to facilitate the coordination and development of programs and procedures to identify possible fraudulent and manipulative activities across markets and to facilitate information sharing related to those efforts. In 2020, the CMRWG was established with U.S. SROs as a working group of the ISG's U.S. Subgroup to focus on ways to reduce unnecessary regulatory duplication.[97] The Commission agrees that continued collaboration will be important.

One commenter stated that an exchange can take action against its member for exchange rule violations associated with the conduct of a non-member broker-dealer that accessed the exchange through the member, or the exchange may refer the activity to another SRO.[98] This commenter also stated that the access-providing exchange member is likely to be a FINRA member.[99] Similarly, other commenters stated that options trading firms that are members of exchanges where they trade options do not need to be FINRA members because, when they conduct off-member-exchange trading activity, they do so through a FINRA member broker-dealer.[100] In the same vein, one commenter stated that volume effected by options trading firms in the equities markets is often processed through FINRA members and, thus, options trading firms effectively trade like customers, making a requirement that they join FINRA no more useful than requiring FINRA registration for any non-broker-dealer customers that trade in the equities market through a FINRA registered broker-dealer.[101]

In response, the Commission does not believe that its concerns regarding non-FINRA member broker-dealers that effect off-member-exchange securities transactions are addressed when such broker-dealers act in the capacity of a customer of another broker-dealer that is a FINRA member. A broker-dealer acting in a customer capacity does not provide a basis for regulatory oversight of that broker-dealer's off-member-exchange activities as required by section 15(b)(8) when the broker-dealer is not a FINRA member. The Commission believes that such activities should be subject to direct, membership-based FINRA oversight, which carries with it an obligation to comply with FINRA's rules and FINRA's direct examination authority. This is not accomplished when a broker-dealer acts as a customer of a FINRA member but is not itself a FINRA member.

In addition, in the scenarios presented by commenters, neither the exchange where the violative conduct occurred nor FINRA would have direct authority to address the conduct of the broker-dealer that is not a member of the exchange (and is not a FINRA member). If the exchange referred the matter to another exchange SRO where the broker-dealer is a member, the two exchanges could have different rules or different interpretations of their respective existing rules. In other words, there would be separate recourse by separate exchanges with potentially different rules or rule interpretations against different broker-dealers for the same conduct on one of the exchanges. The Commission believes this presents the potential for inconsistent outcomes, as the exchange where the conduct occurred could choose to pursue recourse against its member but the referred-to exchange could, for the same conduct, choose not to pursue recourse against its member. A requirement that all broker-dealers that effect off-member-exchange securities transactions become FINRA members (if not exempt under amended Rule 15b9–1) is more consistent with the protection of investors and the public interest. If both broker-dealers were FINRA members in the scenarios presented by

[91] *See* FINRA Letter at 4 (stating that Rule 17d–2 plans and RSAs are not without their limitations).

[92] *See id.* at 8.

[93] In the context of an RSA in which an exchange SRO contracts with FINRA for FINRA to provide regulatory services on behalf of the exchange SRO, FINRA's oversight of the off-member-exchange trading activity of a firm that is a member of the exchange but not a FINRA member is for compliance with the exchange's rules, not FINRA's rules, since FINRA's rules apply only to its members.

[94] *See* FINRA Letter at 5 (stating that RSAs are privately negotiated contracts, vary in their scope of regulatory coverage, and can be terminated by the parties thereto; that FINRA examines for compliance with the rules of certain individual exchanges under RSAs and, therefore, firms that are not FINRA members may be subject to different exchange rules and interpretations with respect to the same activity; and that RSAs do not provide FINRA with membership-based jurisdiction to directly enforce such firms' compliance with the Federal securities laws or subject such firms to FINRA's rules for their OTC trading, even where such trading may not be comprehensively addressed by exchange rules or RSAs). As a result of amended Rule 15b9–1, any broker-dealer that effects off-member-exchange securities transactions will need to join an Association, pursuant to section 15(b)(8) of the Act, unless the broker-dealer's off-member-exchange securities transactions are covered by an exemption in the amended rule.

[95] *See infra* section V (setting forth expiration dates for RSAs).

[96] *See* Nasdaq Letter at 3; *see also* Cboe Letter at 5 (discussing the formation of the ISG and CMRWG to facilitate coordination among the SROs).

[97] *See* FINRA Information Notice—4/8/20 available at *https://www.finra.org/rules-guidance/notices/information-notice-040820* (informing members of the existence and role of the CMRWG).

[98] *See* Cboe Letter at 4.

[99] *See id.* at 2–3.

[100] *See, e.g.,* CTC Letter at 3; Group One Letter at 2.

[101] *See* Cboe Letter at 2–3.

commenters, FINRA could take a consistent approach in addressing both broker-dealers' involvement in the conduct.

Exchange SRO rules would, of course, continue to apply to broker-dealer firms that are exchange members and become FINRA members as a result of the amendments to Rule 15b9–1.[102] The potential for inconsistent recourse by exchanges where such firms are a member could, therefore, continue to exist. But such firms would be common members of FINRA and their member exchanges, and SROs have a statutory obligation to eliminate unnecessarily duplicative oversight of their common members.[103] While FINRA rules and exchange rules would apply to such firms, the Commission believes that Rule 17d–1 DEA designations and Rule 17d–2 plans will likely be utilized in areas of overlap to mitigate duplicative application of exchange SRO and FINRA oversight, in the same fashion as they already are utilized for the many broker-dealer firms that are exchange members and FINRA members. As a result, with respect to broker-dealer firms that become FINRA members and are exchange members, the Commission believes that FINRA likely will be the only SRO with regulatory responsibility regarding these firms' compliance with rules that FINRA and their member exchange(s) have in common.[104] Moreover, FINRA already directly regulates cross-market and off-exchange trading activity by FINRA members for compliance with FINRA rules, and would extend that direct oversight to new FINRA members' off-member-exchange activity (without needing to rely on RSAs to do so). Exchange SROs would remain primarily responsible for their members' on exchange activity (subject to Rule 17d–1 DEA designations, Rule 17d–2 plans, or RSAs). This complementary structure with FINRA as the SRO primarily responsible for off-member-exchange activity by FINRA members and exchange SROs primarily responsible for member exchange activity is consistent with the Exchange Act's statutory framework, which places SRO oversight responsibility with an Association for off-member-exchange securities trading.[105]

The Commission also does not believe that the CAT mitigates the need for proprietary trading broker-dealer firms that effect off-member-exchange securities transactions to be required to join FINRA, as was asserted by some commenters.[106] The CAT is an important audit trail tool through which exchange SROs and FINRA are able to perform surveillance of trading activity in NMS and OTC securities using CAT data.[107] In addition, FINRA has stated that it surveils 100% of the equities and options markets with CAT data.[108] But access to CAT data does not confer jurisdiction to FINRA over a firm that is not a FINRA member and that trades securities off-member-exchange.[109] As a result, when FINRA encounters potentially problematic conduct by firms that are not FINRA members,[110] it lacks the independent ability to examine for and investigate potential violations of, or enforce compliance with, the Federal securities laws, Commission rules, or FINRA rules.[111] Moreover, access to CAT data alone does not enable FINRA to conduct additional investigative methods, such as collecting documents, interviewing witnesses, and otherwise investigating the firm.[112] Even if one or more exchanges of which a broker-dealer is a member and FINRA could coordinate SRO oversight of the non-FINRA member firm's off-member-exchange securities trading activity through the use of CAT data and RSAs, performing SRO oversight pursuant to RSAs is, as discussed above in this section, a less certain and stable approach than direct Association oversight of such trading activity due to the discretionary nature of RSAs, and frustrates the regulatory scheme established by Congress in which an Association directly regulates broker-dealers that effect off-member-exchange securities transactions.[113] And any such coordinated efforts would not apply to U.S. Treasury securities trading activity, which is not reported to the CAT and not covered by RSAs. In short, even with this coordination, FINRA would still not have direct membership-based jurisdiction over the firm. This limitation impedes stable and consistent SRO oversight of off-member-exchange securities trading activity through direct, membership-based FINRA jurisdiction by continuing the dependence upon RSAs for such oversight,[114] and impedes comprehensive SRO oversight of off-member-exchange securities trading activity since RSAs, the CAT, and coordinated regulatory efforts using these tools do not cover U.S. Treasury securities trading activity.[115]

[102] *See, e.g.,* Cboe Letter at 6 (stating that requiring FINRA membership for non-member FINRA firms would add regulatory duplication and administrative burden to the firms and SROs with whom the firm is already a member).

[103] *See* section 17(d)(1) of the Act, 15 U.S.C. 78q(d)(1).

[104] *See infra* note 275 (stating that FINRA serves as the DEA for the majority of member firms).

[105] *See supra* note 26 and accompanying text.

[106] *See, e.g.,* MMI Letter at 2; FIA PTG Letter at 2; Cboe Letter at 2–3; STA Letter at 2–3; ABCV Letter at 3; PEAK6 Letter at 3; Group One Letter at 2; CTC Letter at 4.

[107] Exchange rules require their members to report to CAT. *See, e.g.,* Cboe BYX Rules 4.5 through 4.17; Nasdaq General 7; NYSE Rule 6800.

[108] *See* FINRA Letter at 6.

[109] *Id. See also* Concept Release Concerning Self-Regulation, *supra* note 20, 69 FR 71266 (stating that ''[w]hile the full implementation of robust intermarket order audit trails would be a significant step forward, an order audit trail is simply a tool that can be used by regulators to better surveil for illicit trading activity'' and that ''the SRO regulatory function would still play a critical role in the regulation of intermarket trading''). Likewise, the ISG is a valuable forum for the coordination of regulatory efforts and sharing of information and serves an important function, but it does not confer jurisdiction to FINRA over a broker-dealer that is not a FINRA member and effects off-member-exchange securities transactions. The ISG also does not create rules or impose disciplinary actions; rather, the information sharing between members allows for the proper authority, regulator, or exchange to pursue appropriate rule changes or pursue legal action on market participants based on evidence gathered.

[110] *See, e.g.,* FINRA Letter at 5; 6/20/23 Meeting Memorandum (stating that FINRA identified non-FINRA member broker-dealer firms as potential respondents in 5% of the market regulation investigations it conducted in 2020 and 2021, which ranged across asset types and included both cross-exchange and off-exchange conduct).

[111] *See* FINRA Letter at 6. Such a case may be referred to the Commission or an exchange where the firm is a member for further investigation.

[112] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49938.

[113] *See* Section 15(b)(8) of the Act, 15 U.S.C. 78*o*(b)(8); 2015 Proposing Release, *supra* note 1, 80 FR 18039 at notes 28–33 and accompanying text describing the regulatory history of off-exchange trading. *See also* Cross-Market Regulatory Coordination Staff Paper, *supra* note 14 (stating that ''[w]hile multiple SROs reviewing the same securities activities can have benefits, in that the resources and expertise from several organizations can be brought to bear on assessing these activities, it also can lead to duplication and inefficiencies in the regulatory process and increased burdens on member firms''). FINRA and the exchange SROs have a history of coordinating and can work together to address concerns of firms that are receiving duplicative regulatory requests such as through the Cross Market Regulatory Working Group. *Id.*

[114] As discussed above in this section, if FINRA has an RSA with a given exchange, FINRA is able to apply that exchange's rules to off-member-exchange activity by members of that exchange, even if they are not FINRA members, assuming that the RSA assigned to FINRA the oversight of those rules. But RSAs are not required to continue to exist pursuant to any regulatory requirement, and exchanges with potentially different rules and interpretations thereof retain legal responsibility and decision-making authority under RSAs, which could lead to inconsistent outcomes. FINRA does not need to rely on RSAs for its oversight of FINRA members, and so it can apply its jurisdiction directly to FINRA members' off-member-exchange trading activity. Further, for FINRA member firms that also are exchange members, Rule 17d–1 DEA designations and Rule 17d–2 plans could be utilized in areas of overlap to mitigate duplicative application of exchange and FINRA oversight.

[115] *See* FINRA Letter at 6 (stating that ''there are key regulatory limitations that remain when FINRA encounters potentially problematic Non-Member

Continued

Relatedly, the Commission continues to believe that direct, membership-based FINRA jurisdiction is necessary for proprietary trading broker-dealer firms that effect transactions in U.S. Treasury securities, and that FINRA oversight would not duplicate any exchange SRO oversight in this area.[116] U.S. Treasury securities are not traded on any exchange, and to the Commission's knowledge, unlike FINRA,[117] no exchange SRO possesses expertise on U.S. Treasury securities trading activity. Further, as discussed above in this section, U.S. Treasury securities trading activity also is not covered by RSAs between exchange SROs and FINRA, so RSAs are not a mechanism through which FINRA currently could apply exchange rules (to the extent any would be applicable) to U.S. Treasury securities trading activity by proprietary trading broker-dealer firms that are exchange members but not FINRA members. Thus, aside from certain surveillances (other than the CAT),[118] no SRO oversight is performed with respect to the U.S. Treasury securities trading activity of proprietary trading broker-dealer firms that are not FINRA members.

For example, FINRA stated that, subject to audit trail limitations, it has observed that firms that are not FINRA members were identified in 17 percent of the surveillance alerts generated by its U.S. Treasury security manipulation pattern surveillance in 2020 and 2021.[119] FINRA has no jurisdiction over such firms and, therefore, no authority to address their involvement in potential market misconduct that is identified.[120] Since, to the Commission's knowledge, no exchange SRO has expertise or performs oversight in this area, broker-dealer firms that are not FINRA members may participate in the U.S. Treasury securities market effectively without SRO oversight applied to their activity in that market (other than, as discussed below, what can be discerned by regulators when non-FINRA member broker-dealer U.S. Treasury securities transactions are reported to TRACE by FINRA members).[121] This rulemaking would facilitate oversight consistent with the protection of investors and the public interest.

Insofar as U.S. Treasury securities transaction reporting and transparency in particular are concerned, FINRA's TRACE system is the regulatory vehicle that facilitates mandatory reporting of OTC transactions in U.S. Treasury securities, among other eligible fixed income securities.[122] But as discussed in the 2022 Re-Proposal, proprietary trading broker-dealer firms that are not FINRA members are not required to report their U.S. Treasury securities transactions to FINRA's TRACE system because TRACE reporting obligations for U.S. Treasury securities transactions apply only to broker-dealers that are FINRA members.[123] Thus, exchange SRO membership alone is not enough to subject proprietary trading broker-dealer firms that effect U.S. Treasury securities transactions to FINRA's reporting requirement for such transactions.

When a non-FINRA member broker-dealer trades U.S. Treasury securities through a ''covered ATS,'' the covered ATS is obligated in its TRACE report to identify the non-FINRA member broker-dealer via its Market Participant ID (''MPID''),[124] thus providing visibility to regulators as to what transactions on covered ATSs are attributable to non-FINRA members.[125] But regulators have no such visibility when non-FINRA member broker-dealers trade U.S. Treasury securities otherwise than on a covered ATS. If non-FINRA member broker-dealers trade on a non-covered ATS or bilaterally with a counterparty that is a FINRA member or covered depository institution, the ATS or FINRA member or covered depository institution reports the trade, but the non-FINRA member is not specifically identified via a MPID and instead is identified only as a ''customer.'' [126] If

Firm conduct'' via audit trail data and that the limitations posed by RSAs ''impede comprehensive OTC and cross-market oversight in the equities, options, and fixed income markets'').

[116] Some commenters agreed with the Commission. *See, e.g.,* Cboe Letter at 2 (stating that Cboe believes it is appropriate for broker-dealers that are not FINRA members that effect fixed income transactions to register with FINRA to ensure FINRA insight into, and sufficient regulatory coverage of, those transactions).

[117] *See* FINRA Letter at 8 (stating that individual fixed income securities generally are not traded on exchange and their markets rely exclusively on FINRA oversight); *see also supra* note 76.

[118] *See* FINRA Letter at 10 (stating that FINRA surveils and examines for manipulative or other illegal activity in the fixed income market, including with respect to U.S. Treasury securities trading). As discussed above in this section, trading activity in U.S. Treasury securities is not reported to the CAT, so the CAT is not a tool that can be used by SROs to surveil that activity. A commenter suggested that the Commission could require that TRACE data and other securities trading data be reported to the CAT. *See* Phillip Letter. Such an undertaking would not, however, provide FINRA with needed, membership-based jurisdiction over broker-dealers that trade U.S. Treasury securities.

[119] *See* FINRA Letter at 10; *see also* Better Markets Letter at 9. The 17% figure reflects an upper bound of the rate at which Commission-registered broker-dealers that are not FINRA members appeared in the alerts generated by FINRA's U.S. Treasury security manipulation pattern surveillance in 2020 and 2021. *See* 6/20/23 Meeting Memorandum. The Commission understands that the actual rate at which Commission-registered broker-dealers that are not FINRA members appeared in these alerts is likely lower than 17%, as some portion of the alerts may have involved non-FINRA member proprietary trading firm entities that are not Commission-registered broker-dealers. *Id.* More precise estimates are not possible in light of the way proprietary trading firms are identified under current audit trail rules and the way FINRA evaluates conduct by potentially affiliated entities. *Id.*

[120] *See* FINRA Letter at 10.

[121] As discussed below in this section, the Commission retains authority over broker-dealers, but the Exchange Act contemplates dual layers of oversight of broker-dealers through such Commission authority working in tandem with SRO authority. The focus here is on strengthening the SRO layer of oversight.

[122] *See* FINRA Rule 6700 series. FINRA publishes aggregated transaction information and statistics on U.S. Treasury securities on its website. *See FINRA.org,* Treasury Aggregate Statistics, *available at https://www.finra.org/finra-data/browse-catalog/about-treasury* (last visited Aug. 9, 2023); FINRA Rule 6750, Supplementary Material .01(b); *see also* Securities Exchange Act Release No. 95438 (Aug. 5, 2022), 87 FR 49626 (Aug. 11, 2022) (File No. SR–FINRA–2022–017) (order approving FINRA publication of aggregated U.S. Treasury securities transactions more frequently than weekly, such as on a daily basis). Also, pursuant to effective national market system plans which are also effective transaction reporting plans (as both terms are defined in 17 CFR 242.600(b) (Rule 600(b) of Regulation NMS)), namely the Nasdaq UTP Plan and the CTA Plan, FINRA reports to the Securities Information Processors (''SIPs'') information for off-exchange NMS stock transactions that are reported to FINRA's TRFs, and the SIPs in turn distribute the information in the public consolidated market data feeds. *See* section VIII(a) of the CTA Plan; section VIII.B of the Nasdaq UTP Plan.

[123] *See* FINRA Rule 6720—Participation in TRACE; *see also* 2022 Re-Proposal, *supra* note 1, 87 FR 49938. Since Sept. 1, 2022, certain depository institutions (''covered depository institutions'') have been required to report to TRACE transactions in U.S. Treasury securities, agency debt securities and agency mortgage-backed securities. *See FINRA.org,* Federal Reserve Depository Institution Reporting to TRACE, *available at https://www.finra.org/filing-reporting/trace/federal-reserve-depository-institution-reporting* (last visited Aug. 8, 2023). In addition, in order to enhance the regulatory audit trail and ensure data is reported in a more timely manner, FINRA adopted amendments to Rule 6730 to require members to report U.S. Treasury securities transaction data in the smallest increment available to the member and as soon as practicable, but no later than 60 minutes following a transaction. *See* Securities Exchange Act Release No. 95635 (Aug. 30, 2022), 87 FR 54579 (Sept. 6, 2022).

[124] *See* FINRA Rule 6730—Transaction Reporting, Supplementary Material .07—ATS Identification of Non-FINRA Member Counterparties for Transactions in U.S. Treasury Securities.

[125] In the proposal the Commission issued in Jan. 2022 to, among other things, amend Regulation ATS for ATSs that trade U.S. government securities, and the reopening release issued in Apr. 2023, which provides supplemental information and economic analysis on the Jan. 2022 proposal, the Commission estimated that there would be a number of trading systems that would be required to comply with Regulation ATS under the proposal. *See* Securities Exchange Act Release Nos. 94062 (Jan. 26, 2022), 87 FR 15496, 15585 (Mar. 18, 2022); 97309 (Apr. 14, 2023), 88 FR 29448, 29466 (May 5, 2023).

[126] In 2022, there were approximately 60 million transactions reported in U.S. Treasury securities, totaling $165 trillion in dollar volume. Approximately 35.7 million of those transactions,

non-FINRA member broker-dealers trade U.S. Treasury securities otherwise than on an ATS and with a counterparty that is not a FINRA member and not a covered depository institution, there is no TRACE reporting obligation and the trade is not reported.[127]

The Commission continues to believe that regulators' lack of visibility into U.S. Treasury securities transactions effected by proprietary trading broker-dealer firms that are not FINRA members, in the circumstances described above in which such firms are not identified by MPID in TRACE data, detracts from the comprehensiveness of U.S. Treasury securities TRACE data and regulators' ability to utilize that data to reconstruct market events, and detect and deter improper trading activity in the U.S. Treasury securities market.[128] The Commission does not know if all U.S. Treasury securities transactions by non-FINRA member broker-dealer firms are reported to TRACE, and for those that are reported, any non-FINRA member broker-dealer firm that is a counterparty remains anonymous if the transaction did not occur on a covered ATS. As a result, the Commission cannot quantify total secondary market trading by broker-dealers in U.S. Treasury securities, and regulators cannot readily identify from TRACE when a non-FINRA member broker-dealer is the source of reported U.S. Treasury securities order flows executed otherwise than on a covered ATS and cannot link any such order flows to any particular non-FINRA member broker-dealer.[129] Moreover, broker-dealers that are not FINRA members have a potential competitive advantage over those that are FINRA members, as FINRA members incur the costs of reporting transactions in U.S. Treasury securities transactions but non-FINRA members do not.[130]

Some commenters broadly agreed with the Commission's concern, expressed in the 2022 Re-Proposal, regarding transparency and reporting of U.S. Treasury securities transactions by proprietary trading broker-dealer firms that are not FINRA members.[131] Other commenters stated that there is no reporting gap that must be addressed with respect to U.S. Treasury securities transactions by proprietary trading broker-dealer firms that are not FINRA members because, according to the commenters, existing TRACE reporting requirements meaningfully capture effectively all proprietary broker-dealer U.S. Treasury securities transactions.[132] One of these commenters also stated that potential concerns around the identification of non-FINRA member counterparties to U.S. Treasury securities transactions on non-covered ATSs are not implicated by proprietary broker-dealer transactions in any meaningful way, or could be remedied by requiring that such transactions be reported with account ownership identifiers, which, according to the commenter, would not necessitate FINRA membership.[133] Similarly, other commenters suggested, as an alternative to what the Commission has proposed, an approach under which proprietary trading broker-dealer firms could remain exempt from section 15(b)(8)'s Association membership requirement so long as they report their U.S. Treasury securities transactions to FINRA's TRACE system.[134]

The reporting requirements suggested by commenters could help address the potential anonymity of proprietary trading broker-dealer firms in TRACE data. But as discussed above in this section, a lack of transparency to regulators when non-FINRA member broker-dealers trade U.S. Treasury securities—and the resulting difficulty it poses for regulators when trying to identify the source of U.S. Treasury securities order flows, detect and deter improper trading activity, and reconstruct market events—is not the full scope of what the Commission believes must be addressed. There also is the necessity, described above in this section, for FINRA to have the authority to allow it to independently examine for, investigate, or address potential off-member-exchange misconduct by proprietary trading broker-dealer firms in the securities markets, including the

representing approximately $64 trillion in dollar volume, were executed on ATSs. The balance of approximately 24.3 million reported transactions, or $100 trillion in dollar volume, that was not traded on an ATS was reported by FINRA members with a counterparty that, if not a FINRA member, was identified as a ''customer'' in the reported data. The Commission estimates that approximately 12.7 million transactions and $60 trillion in dollar volume not executed on an ATS had a counterparty identified as a ''customer'' in the reported data. This represents 52% of the 24.3 million transactions and 60% of the $100 trillion in dollar volume not executed on an ATS, or 21% of the 60 million total transactions and 36% of the $165 trillion total dollar volume. Further, the Commission estimates that, of the 35.7 million transactions and $64 trillion in dollar volume executed on an ATS, approximately 98.2% of that transaction volume and 99% of that dollar volume was executed on a covered ATS; approximately 1.8% of the 35.7 million transactions and 1% of the $64 trillion dollar volume, representing approximately 0.6 million transactions and $536 billion, respectively, was executed on a non-covered ATS; and approximately 4.8% of the 0.6 million transactions and 22% of the $536 billion in dollar volume executed on a non-covered ATS, representing approximately 15,000 transactions and $59 billion, respectively, was reported with a counterparty identified as a ''customer.'' Customer volume and transaction counts are calculated as half the sum of ATS-to-customer buys and ATS-to-customer sells.

[127] In addition, in the context of an NMS stock transaction effected between a FINRA member and a non-FINRA member otherwise than on an exchange, only the FINRA member is obligated to report the transaction to the FINRA TRF and the non-FINRA member generally is not identified on the trade report as the contra party to the trade. *See* Trade Reporting Frequently Asked Questions, Reporting Relationships and Responsibilities, section 202: Reporting Trades with a Non-FINRA Member, *available at https://www.finra.org/filing-reporting/market-transparency-reporting/trade-reporting-faq#202* (last visited Aug. 9, 2023). The non-FINRA member is, however, identified in CAT in this context.

[128] For example, in a Nov. 2021 report, an inter-agency working group comprised of staff of the U.S. Department of the Treasury, Commission, Commodity Futures Trading Commission, Federal Reserve Bank of New York, and Board of Governors of the Federal Reserve System stated that ''[i]n March 2020, large flows from investors were captured by TRACE data but were not identifiable beyond the FINRA-member dealer intermediary that facilitated the trade. Understanding the source of these flows required the official sector to contact dealers, wait for other datasets that are significant lagged, and rely on separate sources of information.'' *See* U.S. Dep't of the Treasury et al., Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report (Nov. 8, 2021) (''2021 Interagency Report'') *available at https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf.*

[129] *See id.*

[130] *See supra* section V.C.2 for estimated costs of TRACE reporting.

[131] *See* FINRA Letter at 9 (stating that FINRA has no visibility into the identity of non-FINRA firms for U.S. Treasury securities transactions that occur otherwise than on a covered ATS or on any other non-ATS platform); Better Markets Letter at 9 (stating that a significant proportion of U.S. Treasury securities transaction activity is performed on a bilateral basis without data reporting requirements, and that this lack of visibility undermines regulators' ability to monitor risks, understand how those risks evolve into potentially systemic risks, and react to them in real-time, and inhibits robust price discovery) (citing 2021 Interagency Report, *supra* note 128); Cboe Letter at 9.

[132] *See* FIA/PTG Letter at 3 (acknowledging concerns regarding the identification of non-FINRA member counterparties but noting they are not aware of the situation applying to proprietary broker-dealer transactions in a ''meaningful'' way); MMI Letter at 2 (arguing CAT and TRACE data ''effectively captures'' all proprietary broker-dealer transactions). It is difficult to assess the accuracy of the commenter statement that there is no reporting gap with respect to U.S. Treasury securities transactions by proprietary trading broker-dealer firms that are not FINRA members because, as discussed above in this section, if non-FINRA member broker-dealers trade U.S. Treasury securities otherwise than on an ATS and with a counterparty that is not a FINRA member and not a covered depository institution, there is no TRACE reporting obligation and the trade is not reported. And even when a non-FINRA member broker-dealer's transactions in U.S. Treasury securities are reported by a counterparty that does have a TRACE reporting obligation, such as a FINRA member or covered depository institution, the non-FINRA member is identified only as ''customer'' in the reported data unless the transaction occurred on a covered ATS.

[133] *See* FIA/PTG Letter at 3.

[134] *See, e.g.,* PEAK6 Letter at 6; Group One Letter at 2; CTC Letter at 3; Cboe Letter at 7; Virtu Letter at 7.

markets for U.S. Treasury securities, equities and options. Such FINRA authority is necessary notwithstanding the Commission's authority over broker-dealers in order to strengthen the SRO layer of oversight of off-member-exchange securities trading, consistent with the dual Commission and SRO oversight of broker-dealers required by the Exchange Act.[135] As a membership-based organization, FINRA's jurisdiction, and thus its authority, is limited to its members and their associated persons. As such, authority to independently examine, investigate, or enforce potential violations against non-FINRA member broker-dealers is not conferred to FINRA through reporting requirements without FINRA membership. For example, FINRA stated that it identified non-FINRA member broker-dealer firms as potential respondents in five percent of the market regulation investigations it conducted in 2020 and 2021, which ranged across asset types and included both cross-exchange and off-exchange conduct), and FINRA identified non-FINRA member firms in 17 percent of the surveillance alerts generated by its U.S. Treasury security manipulation pattern surveillance in 2020 and 2021.[136] If those non-FINRA member firms could remain exempt from section 15(b)(8)'s Association membership requirement as long as they report their U.S. Treasury securities transactions to TRACE, FINRA would continue to lack the independent ability to examine and investigate those firms to generate evidence, such as by collecting documents and interviewing witnesses.

In contrast, the rescission of the *de minimis* allowance and proprietary trading exclusion helps solve both for the need for FINRA authority over off-member-exchange securities trading activity and for the anonymity in TRACE data of proprietary trading broker-dealer firms when they trade U.S. Treasury securities otherwise than on a covered ATS. Under the adopted approach, proprietary trading broker-dealer firms that effect off-member-exchange securities transactions and that become FINRA members will be subject to direct, membership-based FINRA jurisdiction. Further, those that effect U.S. Treasury securities transactions otherwise than on a covered ATS will be specifically identified by MPID in TRACE.[137]

In addition to discussing existing regulatory mechanisms and suggesting reporting-specific requirements as alternatives to FINRA membership, commenters addressed the Commission's position, set forth in the 2022 Re-Proposal, that it is appropriate for FINRA to exercise direct, membership-based oversight over firms that do not carry customer accounts.[138] FINRA agreed with the Commission that direct, membership-based FINRA oversight over proprietary trading broker-dealer firms would be appropriate even though they typically do not carry customer accounts.[139] FINRA stated that active trading firms have the potential to introduce risk into the markets even where they do not have customers, and for that reason, FINRA's rules and regulatory programs cover a cross section of activity and risks beyond sale practices.[140] FINRA stated that certain member risk controls overseen by FINRA are particularly relevant to proprietary trading dealer firms, such as controls for credit risk to counterparties, market risk, market integrity risk, and liquidity risk.[141] FINRA also observed that while non-FINRA members may not have customers of their own, they nonetheless can have a significant role executing customer orders routed to them by other broker-dealers.[142] Other commenters stated that FINRA regulation is customer-focused and not appropriate for proprietary trading firms that do not carry customer accounts.[143]

The Commission continues to believe that it is appropriate for FINRA to have direct, membership-based jurisdiction over proprietary trading broker-dealer firms that effect off-member-exchange securities transactions even though such firms typically do not carry customer accounts. As discussed above,[144] several non-FINRA member broker-dealer firms that do not carry customer accounts effect significant volumes of off-member-exchange securities transactions. The Commission believes that such firms—and such trading activity—should not remain exempt from FINRA's direct, membership-based oversight on the basis that such firms do not carry customer accounts. FINRA's ability to create a consistent regulatory framework for all broker-dealers that effect off-member-exchange securities transactions is undermined by the subset of such broker-dealers that do not carry customer accounts and are not FINRA members in reliance on Rule 15b9–1.[145] The rescission of the *de minimis* allowance and proprietary trading exclusion will help address this by eliminating the legal basis upon which such firms generally are able to effect off-member-exchange securities transactions without joining FINRA.

In particular, as discussed in the 2022 Re-Proposal, FINRA is well-positioned to exercise direct oversight over such firms. FINRA has established a regulatory regime for broker-dealers that effect off-member-exchange securities transactions that applies to FINRA members regardless of whether they handle customer orders or carry customer accounts.[146] For example,

[135] *See supra* note 22 (stating that Congress historically has favored self-regulation for a variety of reasons, including that effectively regulating the inner-workings of the securities industry at the Federal level was viewed as cost prohibitive and inefficient; the complexity of securities practices made it desirable for SRO regulatory staff to be intimately involved with SRO rulemaking and enforcement; and the SROs could set standards such as just and equitable principles of trade and detailed proscriptive business conduct standards).

[136] *See* FINRA Letter at 5, 10; *see also* 6/20/23 Meeting Memorandum (specifying that non-FINRA member broker-dealer firms made up the 5% of the market regulation investigations that FINRA conducted in 2020 and 2021, and that the 17% figure reflects an upper bound of the rate at which Commission-registered broker-dealers that are not FINRA members appeared in the alerts generated by FINRA's U.S. Treasury security manipulation pattern surveillance in 2020 and 2021).

[137] *See* FINRA Rule 6730—Transaction Reporting, Supplementary Material .07—ATS Identification of Non-FINRA Member Counterparties for Transactions in U.S. Treasury Securities. FINRA membership also would require that such firms be identified in off-exchange NMS stock transaction reports to FINRA's TRFs, and thus promote broader public market transparency in NMS stocks. *See* FINRA Rule 6000 Series—Quotation, Order, and Transaction Reporting Facilities and FINRA Rule 7000 Series—Clearing, Transaction and Order Data Requirements, and Facility Charges; *see also supra* note 17; 2022 Re-Proposal, *supra* note 1, 87 FR 49942.

[138] *See, e.g.,* FINRA Letter at 11; ABCV Letter at 2; PEAK6 Letter at 2; Group One Letter at 1–2; letter from James Toes, President & CEO, and Kate McAllister, Chair of the Board, Securities Traders Association (Oct. 5, 2022) (''STA Letter'') at 3–4.

[139] *See* FINRA Letter at 11 (stating that certain proprietary trading dealer firms that are not FINRA members have a significant market footprint and the scope of their activities introduces a moderate to high degree of risk to the market and market counterparties).

[140] *See id.*

[141] *Id.*

[142] *See id.* at 7–8.

[143] *See, e.g.,* ABCV Letter at 2; PEAK6 Letter at 2; Group One Letter at 1–2; STA Letter at 3–4.

[144] *See* section II.B, *supra.*

[145] *See* FINRA Letter at 11 (stating that FINRA jurisdiction over proprietary trading dealer firms and the ability to identify their activity in all of FINRA's audit trails would further enable FINRA to assess individual entities' impacts on the market and market counterparties, and that the 2022 Re-Proposal would enable FINRA to directly and more comprehensively oversee such firms and their trading activity, which, in turn, would enhance market integrity and foster the maintenance of fair, orderly, and efficient markets); Better Markets Letter at 5 (stating that the amendments to Rule 15b9–1 would ''help ensure that dealers such as high-frequency trading firms, which conduct an enormous volume of trading, are subject to consistent and robust oversight through FINRA, not only the more narrow regulatory requirements that are specific to each exchange'').

[146] Many broker-dealer firms that derive all or most of their revenue from proprietary trading already are FINRA members. *See* Securities

FINRA, not unlike exchanges, has developed a detailed set of rules in core areas such as trading practices,[147] business conduct,[148] financial condition and operations,[149] and supervision,[150] many of which apply to FINRA members regardless of whether they handle customer orders or carry customer accounts.[151] As another example, FINRA's transaction reporting regime is not limited to broker-dealers with customers and applies to FINRA members regardless of whether they handle customer orders or carry customer accounts.[152] Continuing to permit an exemption from FINRA membership on the basis that broker-dealers that, for example, trade U.S. Treasury securities proprietarily do not have customers would not help improve the comprehensiveness of U.S. Treasury securities transaction TRACE data or address the potential competitive advantage of non-FINRA member broker-dealers that, unlike FINRA member broker-dealers, may trade U.S. Treasury securities without incurring the costs of reporting those trades to TRACE.

The Commission also continues to believe that it is important to the protection of investors and the public interest that FINRA has direct, membership-based jurisdiction over proprietary trading broker-dealer firms that effect off-member-exchange securities transactions regardless of whether they carry customer accounts. An Association's regulatory responsibility, like exchange SROs', includes an obligation to enforce compliance with the Federal securities laws and rules thereunder and the SRO's rules. As an Association, the Exchange Act's statutory framework places SRO oversight responsibility with FINRA for off-member-exchange securities trading, and FINRA is well-positioned to carry out this responsibility with respect to its members.

For example, FINRA gains familiarity with a member's operational risk by assigning dedicated staff members to each firm (*e.g.,* a Risk Monitoring Analyst to act as the primary point of contact and a Risk Monitoring Director) and having staff with subject matter expertise relevant to a member's business model conduct examinations and carry out monitoring duties.[153] Firms are classified into five primary business models and then further sorted into various subgroups overseen by exam and risk monitoring staff.[154] Risk monitoring teams seek to understand the unique aspects of each firm monitored, and use that expertise to inform exam staff in the preparation of exams. Employing a risk-based approach, FINRA examines firms on a one, two or four-year frequency and makes use of specialist teams (*e.g.,* anti-money laundering, cybersecurity or fixed income). Further, FINRA gains familiarity with a member's operational risk through customer complaints and regulatory tips or calls, which may trigger a ''cause'' exam (in contrast to the routine exams described above) focusing on the issues raised in the complaints.[155] Finally, FINRA staff is informed of changes in operational risk associated with a material change in business operations or change of control through FINRA Rule 1017.[156] The Continuing Member Application triggered under FINRA Rule 1017, among other things, reviews if the member's contractual and business relationships support the proposed change, if communications and operational systems are appropriate, financial and internal controls, and the adequacy of the member's supervisory system to prevent and detect violations.[157]

The inability of FINRA to directly enforce regulatory compliance by proprietary trading broker-dealer firms that are not FINRA members—whether or not they handle customer orders or carry customer accounts—may create a risk to the fair and orderly operation of the market because FINRA may not be as familiar with the firm's operational risks or other risks posed by the firm's off-member-exchange securities trading activity as FINRA would be with a FINRA member firm, and FINRA may not be as well positioned potentially to mitigate those risks. In addition, if FINRA were to detect that a non-FINRA member is effecting off-member-exchange securities transactions that are not in compliance with the Exchange Act or applicable rules, FINRA would not have direct, membership-based jurisdiction to directly address the behavior.[158]

Exchange Act Release No. 97798 (June 26, 2023), 88 FR 42404, 42406 (June 30, 2023) (''TAF Amendment'') (stating that FINRA estimates that approximately 66 member firms derive all or most of their revenue from proprietary trading). As FINRA members, these broker-dealers are subject to FINRA's rules and FINRA's direct jurisdiction even though they effect securities transactions for their own account and not on behalf of customers.

[147] *See* FINRA Rule 5000 Series—Securities Offerings and Trading Standards and Practices. For instance, FINRA prohibits members from coordinating prices and intimidating other members. *See* FINRA Rule 5240(a) (stating, among other things, that ''[n]o member or person associated with a member shall: (1) coordinate the prices (including quotations), trades or trade reports of such member with any other member or person associated with a member, or any other person; (2) direct or request another member to alter a price (including a quotation); or (3) engage, directly or indirectly, in any conduct that threatens, harasses, coerces, intimidates or otherwise attempts improperly to influence another member, a person associated with a member, or any other person'').

[148] *See* FINRA Rule 2000 Series—Duties and Conflicts.

[149] *See* FINRA Rule 4000 Series—Financial and Operational Rules. For example, FINRA Rule 4370(a) provides, among other things, that ''[e]ach member must create and maintain a written business continuity plan identifying procedures relating to an emergency or significant business disruption. Such procedures must be reasonably designed to enable the member to meet its existing obligations to customers. In addition, such procedures must address the member's existing relationships with other broker-dealers and counterparties. The business continuity plan must be made available promptly upon request to FINRA staff.''

[150] *See* FINRA Rule 3000 Series—Supervision and Responsibilities Relating to Associated Persons. This rule series generally requires FINRA member firms, among other things, to establish, maintain, and enforce written procedures to supervise the types of business in which the firm engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. *See, e.g.,* FINRA Rules 3110 (Supervision), 3120 (Supervisory Control System), and 3170 (Tape Recording of Registered Persons by Certain Firms). *See also* FINRA By-Laws Article III—Qualifications of Members and Associated Persons. Any person associated with a member firm who is engaged in the securities business of the firm—including partners, officers, directors, branch managers, department supervisors, and salespersons—must register with FINRA.

[151] *See, e.g.,* the FINRA rules set forth in notes 17–18, 56–57, 122–124, 137 and 147–150, and accompanying text, *supra.* In addition, FINRA has regulatory programs and staff dedicated to fixed income regulation. *See* FINRA.org, Key Topics—Fixed Income, *available at https://www.finra.org/rules-guidance/key-topics/fixed-income#overview.*

[152] *See* FINRA Rule 6000 Series (Quotation, Order, and Transaction Reporting Facilities).

[153] *See* FINRA Risk Monitoring Program, FINRA, *available at https://www.finra.org/contact-finra/risk-monitoring-program;* FINRA Examination and Risk Monitoring Programs, FINRA, *available at https://www.finra.org/rules-guidance/key-topics/finra-examination-risk-monitoring-programs#overview.*

[154] *See* FINRA Examination and Risk Monitoring Programs, FINRA, *available at https://www.finra.org/rules-guidance/key-topics/finra-examination-risk-monitoring-programs#overview.*

[155] *Id.*

[156] *See* FINRA Rule 1017; Form CMA, FINRA, *available at https://www.finra.org/registration-exams-ce/broker-dealers/registration-forms/form-cma.*

[157] *See* Filing a Change in Membership Application, The ''What to Expect'' Webcast Series (2010), FINRA, *available at https://www.finra.org/sites/default/files/Education/p018711.pdf.*

[158] FINRA could refer such a matter to the Commission or to an exchange where the firm is a member or, as discussed above in this section, potentially address the matter through an RSA if covered by the terms of the RSA. *See also supra* note 14. But FINRA may lack certain investigative tools, discussed above in this section, with respect to non-FINRA member broker-dealers that it possesses with respect to FINRA members, which could help FINRA further investigate potentially violative behavior before making a referral to the

Continued

As is discussed in the 2022 Re-Proposal and in more detail in the Economic Analysis, *infra* section V, firms that become FINRA members as a result of the adopted rule amendments will be required to apply for membership with FINRA and become subject to the fees charged by FINRA to all of its member firms. FINRA charges each member firm certain regulatory fees designed to recover the costs to FINRA of the supervision and regulation of members, including performing examinations, financial monitoring, and policy, rulemaking, interpretive, and enforcement activities.[159] These regulatory fees include a Trading Activity Fee (''TAF'').[160] FINRA issued a Regulatory Notice in 2015 in which it proposed to amend the TAF such that it would not apply to transactions by a proprietary trading firm effected on exchanges of which the firm is a member.[161] In June 2023, after the 2022 Re-Proposal, FINRA filed a proposed rule change with the Commission, pursuant to section 19 of the Act, to amend the TAF such that it does not apply to transactions by a proprietary trading firm effected on exchanges of which the firm is a member.[162] FINRA designated this proposed rule change as ''establishing or changing a due, fee or other charge'' under section 19(b)(3)(A)(ii) of the Act and 17 CFR 240.19b–4(f)(2) (''Rule 19b–4(f)(2)'') thereunder, which renders the rule effective upon filing with the Commission.

Comments on the 2022 Re-Proposal, submitted prior to the TAF Amendment, stated that the costs of applying for FINRA membership, as well as ongoing costs of FINRA membership such as the TAF, are high and burdensome and could affect liquidity provision.[163] In particular, commenters stated that proprietary options trading firms should remain exempt from section 15(b)(8)'s Association membership requirement because they do not trade U.S. Treasury securities and the equities transaction volume that they effect is hedging activity.[164] Commenters urged the Commission to adopt an exemption for proprietary options trading broker-dealer firms, such that their off-member-exchange securities trading activity would not trigger section 15(b)(8)'s Association membership requirement if such activity is to hedge or in furtherance of their options trading activity on their member exchange(s).[165] If proprietary options trading firms do not remain exempt, commenters stated, there could be a negative impact on options market liquidity and smaller options trading firms could cease trading, which could lead to consolidation and decreased competition.[166] FINRA stated that most proprietary trading dealer firms that newly join FINRA would not incur membership application fees exceeding $12,500.[167] FINRA also stated (prior to filing the TAF Amendment with the Commission) that it is committed to amending the TAF to lessen its impact on such firms.[168]

The Commission believes that a hedging exemption for broker-dealers that are proprietary options trading firms, like that sought by commenters, could continue to result in a significant volume of off-member-exchange trading activity not being subject to direct, membership-based FINRA oversight. Proprietary options trading firms make up the majority of the 12 firms that the Commission identified above as accounting for 5.1% of all off-exchange listed equities volume in April 2023 and the majority of the 21 firms that the Commission identified as accounting for approximately 99% of the $262 billion in listed equities transaction volume executed on exchanges where they are not a member.[169] As a result, significant off-member-exchange trading activity could continue not to be subject to direct FINRA oversight under commenters' suggested exemption. The Commission continues to believe that this would not be consistent with the protection of investors or the public interest, or with the historical rationale for Rule 15b9–1 of accommodating limited off-member-exchange trading activities.[170]

Commission or an exchange, or help prevent FINRA from failing to make referrals when they are warranted. *See also* section V, *infra*. Further, the Commission believes that regulatory efforts based on discretionary RSA arrangements among exchange SROs and FINRA, while beneficial in many contexts, are a less stable and consistent mechanism for SRO oversight than the FINRA membership required by the Exchange Act in the context presented here, and are less comprehensive than membership-based FINRA oversight because they do not cover U.S. Treasury securities trading activity.

[159] *See* FINRA Schedule A to the By-Laws of the Corporation (''FINRA Schedule A''), at section 1, *available at https://www.finra.org/rules-guidance/rulebooks/corporate-organization/section-1-member-regulatory-fees.*

[160] FINRA uses the TAF to recover the costs to FINRA of the supervision and regulation of members, including performing examinations, financial monitoring, and policy, rulemaking, interpretive, and enforcement activities. *See* FINRA Schedule A, at section 1(a). The TAF is generally assessed on FINRA member firms for all equity sales transactions that are not performed in the capacity of a registered exchange specialist or market maker. *See id.* at section 1(b). FINRA charges its members other fees as well, such as an annual Gross Income Assessment (''GIA''). *See id.* at section 1.

[161] *See* FINRA Regulatory Notice 15–13, Trading Activity Fee (May 2015), *available at http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-13.pdf.* FINRA re-opened the comment period on its 2015 Regulatory Notice after the 2022 Re-Proposal. *See* FINRA Regulatory Notice 22–30, Trading Activity Fee (Dec. 15, 2022) *available at https://www.finra.org/sites/default/files/2022-12/Regulatory-Notice-22-30.pdf.*

[162] *See* TAF Amendment. The TAF Amendment's implementation date, which FINRA will announce in a Regulatory Notice, will be no earlier than the date of the Commission's adoption of amended Rule 15b9–1 and no later than the effective date of amended Rule 15b9–1. *Id.*

[163] *See, e.g.,* MMI Letter at 3; PEAK6 Letter at 4–5; FIA PTG Letter at 4; Group One Letter at 2–3; ABCV Letter at 2–3; CTC Letter at 4; Cboe Letter at 7. One commenter estimated that some proprietary broker-dealers would incur TAF fees greater than $1,000,000 per year under the current TAF structure. *See* FIA PTG Letter at 4. Another commenter opined on the substance of FINRA's contemplated TAF amendment. *See* PEAK6 Letter at 4. Some commenters also stated that FINRA must amend the TAF before the Rule 15b9–1 amendments are adopted so firms can assess the fee-related costs of FINRA membership on proprietary trading firms. *See* PEAK6 Letter at 4; FIA PTG Letter at 4.

[164] *See, e.g.,* Cboe Letter at 3; *see also* ABCV Letter at 2 (stating that any trading by options market makers in the underlying cash equities markets is related to legitimate hedging of their options positions).

[165] *See* Cboe Letter at 2–3; ABCV Letter at 3–4; CTC Letter at 5; PEAK6 Letter at 4; Nasdaq Letter at 2. Commenters also stated that options trading firms' equities volume often is processed through a FINRA member, and stated that a hedging exemption would be particularly appropriate if the routing away from a member exchange is through a broker-dealer that is a FINRA member. *See* Cboe Letter at 2–3; ABCV Letter at 2–4; CTC Letter at 5; PEAK6 Letter at 4. As discussed *supra* in this section, the Commission does not agree. *See supra* notes 98–101 and accompanying text.

[166] *See* STA Letter at 3–4; Cboe Letter at 2–3, 7; ABCV Letter at 2–4; CTC Letter at 5; PEAK6 Letter at 4–6.

[167] *See* FINRA Letter at 12 n. 40 (also stating that FINRA does not anticipate that new member proprietary trading dealer firms would incur the one-time clearing surcharge that applies to new applicants engaged in clearing and carrying activity).

[168] *See id.* at 14. *See also* note 170 and accompanying text, *infra.*

[169] *See* section II.B, *supra.*

[170] *See* 2022 Re-Proposal, *supra* note 1, sections III.B.2 and III.C, 87 FR 49947–50. Section 15(b)(9) of the Act provides the Commission with the authority, by rule or order, and as it deems consistent with the public interest and the protection of investors, to conditionally or unconditionally exempt from the requirements of section 15(b)(8) any broker or dealer or class of brokers or dealers. Accordingly, if a broker or dealer or class of brokers or dealers believes that it should be exempted from the requirements of section 15(b)(8) in a manner that is not provided by amended Rule 15b9–1, it may seek an exemption from the Commission, by order, pursuant to section 15(b)(9). For example, the Commission may consider granting such an exemption, where appropriate, if a dealer or class of dealers chooses to limit its exchange trading activity to the physical floor of an exchange of which it is a member, but must effect limited securities transactions elsewhere for its own account in order to facilitate its exchange-floor business.

The effect of not including a hedging exemption in Rule 15b9–1 will be that proprietary options trading broker-dealer firms (among other types of proprietary trading broker-dealer firms) will no longer be exempt from section 15(b)(8)'s Association membership requirement if they effect off-member-exchange securities transactions (unless they are covered by one of the exemptions in the amended rule). Therefore, these firms will be required by section 15(b)(8) of the Act to join FINRA in order to continue any off-member-exchange securities trading activity. The Commission is mindful of the FINRA membership costs, including application and TAF fees, that would be incurred by proprietary trading broker-dealer firms, including options trading firms, that join FINRA as a result of the rescission of the *de minimis* allowance and proprietary trading exclusion, and the Commission is mindful of the potential impact of those costs on options market liquidity.

The Commission believes it is unlikely, however, that such firms would be unable to continue operating their trading businesses or providing liquidity in their normal course due to the costs of FINRA membership. Insofar as the costs of joining FINRA are concerned, the Commission believes that a $12,500 FINRA membership application fee would be manageable for proprietary trading options firms that newly join FINRA, and is small enough such that it should not materially impact their ability to provide liquidity.[171] As for concerns regarding the TAF, an ongoing FINRA cost, FINRA, after considering the potential impact of the TAF on proprietary trading firms that join FINRA, has amended its rules to provide an exemption from the TAF for all proprietary trading firms for transactions executed on an exchange of which the proprietary trading firm is a member.

In addition, commenters stated that small options trading firms could be adversely affected by the rule amendments to the point of providing less liquidity or ceasing to trade.[172] While commenters did not indicate how they are defining ''small'' options firms, the Commission believes that smaller firms should be able to absorb the ongoing costs of FINRA membership, such as the GIA and TAF.[173] As discussed in the Economic Analysis below,[174] the estimated aggregate costs for the 12 largest non-FINRA member broker-dealer firms as of April 2023 represent the majority of the aggregate costs stemming from the amendments to Rule 15b9–1. Therefore, the Commission believes that smaller non-FINRA member broker-dealer firms as well as new entrants will experience much lower initial and ongoing costs and that these FINRA membership costs would not materially impede their ability to continue their trading businesses, which may include providing liquidity in the options market, if they join FINRA.[175]

Further, since the 2015 Proposal, as commenters observed, there has been a decrease in the number of Commission-registered broker-dealers that are exchange members but not FINRA members.[176] There also has been significant consolidation among broker-dealers generally over the past decade.[177] Meanwhile, despite this decline in the number of firms, options market liquidity has remained robust, as reflected by data suggesting that options quoted spreads have remained flat or slightly declined in recent years as overall option trading volumes have continued to hit record highs.[178] Therefore, as discussed in the Economic Analysis below,[179] the Commission does not believe that the adopted rule amendments will undermine options market liquidity provision. In addition, as discussed in the Economic Analysis below,[180] the Commission believes that amended Rule 15b9–1 is not likely to have an economically meaningful effect on direct capital formation, and that changes in the allocation of regulatory fees and direct FINRA supervision within the off-member-exchange market may result in improved efficiency of capital allocation by the financial industry, as current FINRA members might commit additional capital to liquidity provision when the trading environment has more uniform regulatory requirements.

Finally, commenters stated that the Commission already possesses and can exercise authority over Commission-registered broker-dealers that are not FINRA members.[181] While this is

[171] *See infra* section V.C.2 (stating that the Commission believes that the median application fee for the 12 largest (by volume traded) non-FINRA member broker-dealer firms would be $12,500).

[172] *See* STA Letter at 3–4; ABCV Letter at 2–3; Cboe Letter at 7; Nasdaq Letter at 3–4.

[173] *See infra* section V.C.2 (stating that the 12 largest non-FINRA member broker-dealer firms (as measured by off-exchange equities volume traded in April 2023) had average and median annual total revenues of approximately $1.2 billion and $491 million, respectively, in 2022; would incur an estimated median GIA of $327,870; and would incur an estimated median and average TAF of approximately $119,256 and $304,994, respectively).

[174] *See infra* section V.C.2.

[175] The Commission believes that the potential FINRA membership costs that could be incurred by firms not among the 12 largest non-FINRA member broker-dealers is the best data point available to the Commission to assess commenters' assertion. As discussed in section V.B.2, *infra,* the Commission cannot, however, rule out the possibility that the addition of FINRA costs will serve as a catalyst for one or more small non-FINRA member options market makers to exit the market, although FINRA's exemption of TAF fees should reduce the likelihood that firms will choose to exit in response to the adopted rule amendments. In addition, as discussed in section VII, *infra,* the Commission estimates that not more than three of the 64 non-FINRA member broker-dealer firms that the Commission identified as of April 2023 have total capital of less than $500,000 and are not affiliates of any person (other than a natural person) that is not a small business or small organization and would, as a result, be considered small entities under Regulatory Flexibility Act (''RFA'') standards. These three small firms—by RFA standards—could be significantly impacted by the adopted rule amendments because they could be required to become a member of FINRA under section 15(b)(8) of the Act, if they effect off-member-exchange securities transactions and do not qualify for one of the adopted exemptions. These three firms are not among the 12 largest non-FINRA member broker-dealer firms identified by the Commission, and so, as discussed in the paragraph above and in section V.C.2 *infra,* their initial and ongoing FINRA membership costs, should they join FINRA, likely would be low. This suggests that, while they could be significantly impacted by the adopted rule amendments in that they may no longer be exempt from FINRA membership, their trading businesses nevertheless might not be materially impeded by the costs of FINRA membership.

[176] *See* STA Letter at 3–4; ABCV Letter at 2–3. *See also infra* section V.B.2. The decrease is largely the result of such firms ceasing their broker-dealer operations and withdrawing their registration as broker-dealers with the Commission.

[177] *See* FINRA.org, 2022 Industry Snapshot, at 13, *available at https://www.finra.org/sites/default/files/2022-03/2022-industry-snapshot.pdf* (last visited Aug. 8, 2023) (reflecting the following number of FINRA-registered firms in 2017–2021: 3,726 in 2017; 3,607 in 2018; 3,517 in 2019; 3,435 in 2020; and 3,394 in 2021); *compare* 2015 Proposal, *supra* note 1, 80 FR 18042, *with* section II.B *supra* (reflecting a decrease in the Commission's estimate of the number of broker-dealers registered with the Commission that are exchange members but not FINRA members from 125 in the 2015 Proposal to 64 as of Apr. 2023). This trend began well before the amendments being adopted in this release, and may or may not continue regardless of the adopted rule amendments. In other words, if options trading firms ceased operating in the future, the Commission does not believe the cause necessarily would be the amendments to Rule 15b9–1 as other factors have caused this trend before these amendments and likely would continue to be relevant.

[178] *See* section V.B, *infra* (among other things, citing an academic study showing that options bid-ask spreads have remained flat since 2015, and citing NYSE Data Insights 2021 Options Year in Review, *available at https://www.nyse.com/data-insights/2021-options-year-in-review, which reflects that options* quoted spreads have remained flat or slightly declined in recent years as overall option trading volumes have continued to hit record highs).

[179] *See id.*

[180] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49960; section V.B.1, *infra.*

[181] *See, e.g.,* Virtu Letter at 2.

true,[182] as discussed above and in the 2022 Re-Proposal,[183] the Exchange Act requires dual SRO and Commission oversight of registered broker-dealers, with SROs acting as robust, front-line regulators of their broker-dealer members. While the Commission retains examination authority over the SROs and can bring enforcement actions, including pursuant to SRO referrals, that Commission layer of regulatory oversight is meant to work in tandem with, not in place of, a robust front-line layer of SRO oversight. The Commission continues to believe that the front-line layer of SRO oversight must be strengthened with respect to proprietary trading broker-dealer firms that effect off-member-exchange securities transactions notwithstanding the Commission's plenary jurisdiction over Commission-registered broker-dealers. Section 15(b)(8)'s complementary SRO oversight structure generally has enabled exchange SROs to specialize in oversight of securities trading activity that occurs on the exchange, and FINRA to specialize in oversight of off-member-exchange securities trading activity. The Commission continues to believe that rescinding Rule 15b9–1's *de minimis* allowance and proprietary trading exclusion would better enable robust and consistent FINRA oversight in the area of its expertise through direct, membership-based jurisdiction of broker-dealers that effect off-member-exchange securities transactions proprietarily. This, in turn, could strengthen the front-line layer of SRO regulatory oversight that is applied to off-member-exchange proprietary securities trading in today's market.[184]

On March 28, 2022, the Commission proposed new rules to further define certain language as used in the definition of ''dealer'' and ''government securities dealer'' under sections 3(a)(5) and 3(a)(44) of the Exchange Act, respectively.[185] Some commenters stated that the amendments to Rule 15b9–1 may affect proprietary trading firms that are not Commission-registered dealers, but could be required to register as such if the definition of ''dealer'' is amended.[186] To the extent the Commission amends the definition of ''dealer'' in the future, the adopted amendments to Rule 15b9–1 would become part of the baseline from which the effects of any such new rule on the definition of ''dealer'' are measured.

B. Narrowed Criteria for Exemption From Association Membership

The Commission proposed to add to Rule 15b9–1 a new paragraph (c) that would set forth two narrow circumstances in which a broker or dealer would continue to be exempt from section 15(b)(8)'s Association membership requirement if it effects transactions in securities otherwise than on an exchange of which it is a member.[187] Specifically, following the existing paragraphs of Rule 15b9–1 that require that a broker or dealer be a member of a national securities exchange and carry no customer accounts (both of which paragraphs would be retained), the Commission proposed to add language that states: ''and, (c) Effects transactions in securities solely on a national securities exchange of which it is a member, except that with respect to this paragraph (c) . . .'' [188] The two proposed exemptions followed in new paragraphs (c)(1) and (2).

As discussed in turn below, the Commission is adopting as proposed new paragraphs (c)(1) and (2) (as well as the above-quoted language).[189] Paragraphs (c)(1) and (2) of the amended rule are intended to provide more focused exemptions from Association membership for types of off-member-exchange activity that are similar to the off-member-exchange activities that Rule 15b9–1 was originally intended to cover, and that are consistent with the protection of investors and the public interest in accordance with section 15(b)(9) of the Act.

1. Routing Exemption

The Commission proposed to add a new paragraph (c)(1) to Rule 15b9–1 that sets forth an exemption from Association membership if a broker or dealer that meets the criteria of paragraphs (a) and (b) of the rule effects transactions in securities otherwise than on a national securities exchange of which it is a member that result solely from orders that are routed by a national securities exchange of which it is a member to comply with Rule 611 of Regulation NMS [190] or the Options Order Protection and Locked/Crossed Market Plan.[191] Relatedly, the Commission also proposed to eliminate from Rule 15b9–1 outdated references to the ''Intermarket Trading System,'' [192] which is a now-obsolete NMS plan that was discontinued in 2007 because it was superseded by Regulation NMS.[193] The Commission is adopting these aspects of the 2022 Re-Proposal by adding new paragraph (c)(1), as re-proposed, to Rule 15b9–1, and by removing from Rule 15b9–1 the ITS provisions in pre-existing paragraphs (b)(2) and (c).

As discussed in the 2022 Re-Proposal, Rule 611 of Regulation NMS requires trading centers, such as national securities exchanges, to establish, maintain, and enforce written policies

[182] *See* section I, *supra;* 2022 Re-Proposal, *supra* note 1, 87 FR 49931–32 (stating that the Commission may bring enforcement actions, including pursuant to referrals made by SROs, to enforce compliance with the Exchange Act and applicable rules).

[183] *See* section I, *supra;* 2022 Re-Proposal, *supra* note 1, 87 FR 49932.

[184] One commenter stated that, ''by adopting a Commission rule requiring certain broker-dealers to register with FINRA, FINRA will become, at least as to those broker-dealers, a 'part of the Government' under the standard set forth by the U.S. Supreme Court in *Free Enterprise Fund* v. *Public Company Accounting Board,* 561 U.S. 477 (2010).'' Letter from W. Hardy Callcott (Sept. 3, 2022). FINRA disputed this. *See* FINRA Letter at 15–20. The Commission disagrees that the amendments to Rule 15b9–1 would make FINRA ''part of the Government'' under *Free Enterprise.* In that case, the Supreme Court reasoned that, ''[u]nlike the self-regulatory organizations,'' the Public Company Accounting Oversight Board was ''a Government-created, Government appointed entity.'' 561 U.S. at 485. These distinctions between FINRA and the PCAOB remain unchanged by the amendments to Rule 15b9–1. *See also, e.g., Desiderio* v. *Nat'l Ass'n of Sec. Dealers, Inc.,* 191 F.3d 198, 206 (2d Cir. 1999) (NASD ''is a private actor, not a state actor,'' because it is a ''private corporation that receives no federal or state funding,'' ''[i]ts creation was not mandated by statute, nor does the government appoint its members or serve on any NASD board or committee.'').

[185] *See* Securities Exchange Act Release No. 94524 (Mar. 28, 2022), 87 FR 23054 (Apr. 18, 2022).

[186] *See, e.g.,* MMI Letter at 3; STA Letter at 2; Virtu Letter at 4.

[187] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49944–49. Relatedly, the Commission proposed that existing paragraph (a) of Rule 15b9–1 would remain the same except it would no longer be numbered as paragraph (a); existing paragraph (a)(1) would be renumbered as paragraph (a); and existing paragraph (a)(2) would be renumbered as paragraph (b). *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49945 n. 156.

[188] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49945.

[189] *See* amended Rule 15b9–1(c), under ''Text of Amendments,'' *infra.* The Commission also is adopting the proposed renumbering of paragraphs (a) and (b) in the amended rule. *See supra* note 187.

[190] 17 CFR 242.611.

[191] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49945. *See also* Options Linkage Plan, *supra* note 22.

[192] The ITS was an NMS plan, the full title of which was ''Plan for the Purpose of Creating and Operating an Intermarket Communications Linkage Pursuant to Section 11A(c)(3)(B) of the Exchange Act of 1934'' (''ITS Plan''). The ITS Plan was provisionally approved by the Commission in 1978 and finally approved by the Commission in 1983. *See* Securities Exchange Act Release Nos. 14661 (Apr. 14, 1978), 43 FR 17419 (Apr. 24, 1978) (''Initial ITS Plan Approval Order''); 19456 (Jan. 27, 1983), 48 FR 4938 (Feb. 3, 1983) (''Final ITS Plan Approval Order''). All national securities exchanges that traded exchange-listed stocks and the National Association of Securities Dealers (''NASD'') were participants in the ITS Plan.

[193] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49945; *see also* Notice of Filing and Immediate Effectiveness of the Twenty Fourth Amendment to the ITS Plan Relating to the Elimination of the ITS Plan, Securities Exchange Act Release No. 55397 (Mar. 5, 2007), 72 FR 11066 (Mar. 12, 2007).

and procedures reasonably designed to prevent trade-throughs in exchange-listed stocks, subject to certain exceptions.[194] In general, Rule 611 protects automated quotations that are the best bid or offer of a national securities exchange or an Association.[195] To facilitate compliance with Rule 611, national securities exchanges have developed the capability to route orders through brokers or dealers (many of which are affiliated with the exchanges) to other trading centers with protected quotations.[196] Similarly, in the options market, the Options Linkage Plan is an NMS plan that requires linkages between the options exchanges to protect the best-priced displayed quotes in the market and to avoid locked and crossed markets.[197] The Options Linkage Plan includes written policies and procedures that provide for order protection and address locked and crossed markets in eligible options classes.[198]

The Commission proposed the routing exemption in paragraph (c)(1) to accommodate securities transactions away from a broker's or dealer's member exchange(s) that are to comply with these regulatory requirements.[199] In essence, a broker or dealer may, as a necessary part of its business trading on exchanges of which it is a member and in light of today's market structure, effect securities transactions elsewhere than an exchange where it is a member solely as a consequence of routing by its member exchange(s) to comply with the requirements of Rule 611 of Regulation NMS or the Options Linkage Plan.[200] The Commission continues to believe that it would be consistent with section 15(b)(9)'s goal of protecting investors and the public interest if transactions effected solely to comply with these regulatory requirements, via routing by the broker's or dealer's member exchange(s), do not trigger section 15(b)(8)'s Association membership requirement for a broker or dealer that otherwise limits its securities transactions to an exchange of which it is a member (or to stock transactions that are covered by the stock-option order exemption discussed below). The routing exemption is intended to serve the limited, narrowly defined purpose of facilitating compliance with intermarket order protection requirements.

The Commission also stated in the 2022 Re-Proposal that it would be consistent with the protection of investors and the public interest to permit reliance on the routing exemption only where the routing is performed by a national securities exchange of which the broker or dealer is a member.[201] The Commission stated that this limitation would help ensure that the broker's or dealer's member exchange has visibility into the routing transactions and thus is better able to provide effective SRO oversight of its member's trading activity that is related to its trading on the exchange and may not be overseen by another SRO if the member is exempt from Association membership under amended Rule 15b9–1.[202]

Some commenters stated that the routing exemption should be broadened for proprietary options trading broker-dealer firms so that it covers routing that is not performed by member-exchange routers.[203] The Commission stated in the 2022 Re-Proposal that this would not be consistent with the protection of investors and the public interest because it could permit scenarios in which there is insufficient SRO oversight of the broker-dealer's off-member-exchange securities trading activity.[204] Commenters suggested that the Commission's concerns in this regard are mitigated in the context of options trading firms because they typically route to non-member exchanges via another broker-dealer,[205] and are especially mitigated where that routing broker-dealer is a FINRA member.[206]

The Commission does not agree. As stated previously, consistent with the original design of Rule 15b9–1, the narrowed exemptions from section 15(b)(8)'s Association membership requirement set forth in amended Rule 15b9–1 are designed to apply to limited off-member-exchange securities trading activity that is ancillary to the registered broker's or dealer's trading activity on a national securities exchange of which it is a member. As stated above, Rule 15b9–1 previously exempted securities transactions effected through the ITS. The ITS Plan required each participant—exchanges and the NASD—to provide electronic access to its displayed best bid and offer, and provided an electronic mechanism for routing orders, called ''commitments to trade,'' to access those displayed

[194] 17 CFR 242.611. *See also* 17 CFR 242.600(b)(94) (defining a ''trade-through'' under Regulation NMS); 17 CFR 240.600(b)(95) (defining ''trading center''); Options Linkage Plan, *supra* note 4 (defining ''trade-through'' in the options context).

[195] 17 CFR 242.611.

[196] *See* 17 CFR 242.600(b)(71) (defining ''protected quotation'' under Regulation NMS); 17 CFR 242.600(b)(70) (defining ''protected bid'' and ''protected offer'' under Regulation NMS); *see also* Options Linkage Plan, *supra* note 4 (defining ''protected bid'' and protected offer'' in the options context).

[197] *See* Options Linkage Plan, *supra* note 4. A locked or crossed market occurs when a trading center displays an order to buy at a price equal to or higher than an order to sell, or an order to sell at a price equal to or lower than an order to buy, that is displayed on another trading center.

[198] *Id.*

[199] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49945.

[200] Amended Rule 15b9–1 provides an exemption from section 15(b)(8) of the Act's Association membership requirement for routing broker-dealers that meet the conditions for the exemption, but it does not provide routing broker-dealers with an exemption from the rules of an exchange that are applicable to routing broker-dealers that operate as facilities of that exchange (and that the exchange uses to conduct routing to other trading centers). As discussed in the 2022 Re-Proposal, a routing broker-dealer continues to be required to comply with the applicable rules of any exchange for which it performs outbound routing services, including those requiring the routing broker-dealer to be overseen by an unaffiliated SRO such as FINRA. *See, e.g.,* Cboe BZX Exchange, Inc. Rule 2.11 (Cboe Trading, Inc. as Outbound Router); NYSE Rule 17(c) (Operation of Routing Broker); Nasdaq Options 5, section 4 (Order Routing).

[201] As stated in the 2022 Re-Proposal, the routing exemption is applicable where the broker's or dealer's member exchange utilizes the services of a designated broker-dealer (which could be affiliated or unaffiliated with the exchange) to perform the exchange's outbound routing. *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49946. An exchange's routing fees must be consistent with the Act, including sections 6(b)(4) and 6(b)(5), which require an equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility of the exchange, and require that the exchange's fees not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

[202] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49946.

[203] *See* Cboe Letter at 3; ABCV Letter at 4. It appeared to the Commission that commenters intertwined this point with a different point, and for the sake of completeness, the Commission has addressed both. Specifically, in this section, the Commission interprets and addresses these comments as a request that the routing exemption cover off-member-exchange securities transactions to comply with intermarket order protection requirements that are effected via routers other than a member exchange router. These and other commenters also requested an exemption for proprietary options trading broker-dealer firms under which their off-member-exchange securities trading activity would not trigger section 15(b)(8)'s Association membership requirement if such activity is to hedge or in furtherance of their options trading activity on their member exchange(s). *See supra* note 165 and accompanying text. This request is addressed in section III.A, *supra.*

[204] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49946.

[205] *See* Cboe Letter at 3.

[206] *See* ABCV Letter at 4. Likewise, commenters suggested that it would be particularly appropriate to continue to exempt options trading firms from section 15(b)(8)'s Association membership requirement where their routing away from a member exchange is through a broker-dealer that is a FINRA member. *See* Cboe Letter at 2–3; ABCV Letter at 3–4; CTC Letter at 5; PEAK6 Letter at 4. As discussed *supra* in section III.A, the Commission does not agree. *See supra* notes 98–101 and accompanying text.

prices.[207] The ITS Plan provided each participant market limited access to the other participant markets for the purpose of avoiding a trade-through or a locked or crossed market.[208] Specifically, the ITS enabled a broker or dealer that was physically present in (and a member of) one market center to transmit its own or its customer's commitment to trade in an ITS-traded stock to another market center, which could then be accepted by a broker or dealer at the receiving market center.[209] When a broker or dealer initiated a commitment to trade from an exchange where it was a member, it did so to prevent orders on its member exchange from trading through or locking or crossing quotations displayed on away market centers, and the member exchange was inextricably involved in the routing activity covered by the exemption.

In contrast, if the routing exemption were expanded, as suggested by commenters, to cover routing for intermarket order protection purposes performed by a non-exchange-designated router on behalf of a broker-dealer trading firm, the exemption could cover trading activity that is not ancillary to the firm's trading activity on any exchange where it is a member. Under the commenters' approach, the trading firm could remain exempt from Association membership while utilizing a non-exchange-designated routing broker-dealer to effect securities transactions solely on off-member-exchange venues without any nexus to an exchange where the trading firm is a member. The Commission remains concerned that, in this type of scenario, there would not be an exchange where the trading firm is a member that has visibility into the routing transactions and that is able to provide effective SRO oversight of the trading firm's order routing activity. Among other things, no exchange where the trading firm is a member would be positioned to assess whether the routing transactions complied with the terms of the exemption. This would be the case even if the routing is performed by a routing broker-dealer that also is a FINRA member.[210] This would be inconsistent with the Commission's intention to continue to permit exemptions from section 15(b)(8)'s Association membership requirement that are narrowly tailored to limited off-member-exchange securities trading activity that is ancillary to the registered broker's or dealer's trading activity on a national securities exchange of which it is a member and, in the Commission's view, would be inconsistent with the protection of investors and the public interest.

To be clear, nothing in amended Rule 15b9–1 prohibits broker-dealer firms from effecting securities transactions away from their member exchange(s) by utilizing routing services provided by non-exchange-designated broker-dealers, so long as they comply with section 15(b)(8) of the Act. Any broker-dealer firm may continue to route orders away from its member exchange(s) for order protection or any other appropriate purposes using non-exchange-designated routing broker-dealers. But a broker-dealer firm cannot do so without joining FINRA, as such trading activity is not exempt from, and therefore would trigger, section 15(b)(8) (assuming the trading activity is not otherwise covered by the stock option order exemption discussed below), which would require Association membership for the firm.[211]

2. Stock-Option Order Exemption

The Commission proposed to add a new paragraph (c)(2) to Rule 15b9–1 that sets forth an exemption from Association membership if a broker or dealer that meets the criteria of paragraphs (a) and (b) of the rule effects off-member-exchange securities transactions, with or through another registered broker or dealer, that are solely for the purpose of executing the stock leg of a stock-option order.[212] The Commission also proposed to require in new paragraph (c)(2) that a broker or dealer seeking to rely on the exemption establish, maintain, and enforce written policies and procedures reasonably designed to ensure and demonstrate that such transactions are solely for the purpose of executing the stock leg of a stock-option order, and that the broker or dealer preserve a copy of its policies and procedures in a manner consistent with 17 CFR 240.17a–4 (''Rule 17a–4'') until three years after the date the policies and procedures are replaced with updated policies and procedures.[213] One commenter referenced the stock-option order exemption.[214] The Commission is adopting paragraph (c)(2) as proposed.

As the Commission stated in the 2022 Re-Proposal, the Commission understands that there are firms that trade stock-option orders whose business is focused on one or more options exchanges of which they are a member, and whose trading elsewhere is primarily to effect the execution of stock orders to facilitate their stock-option order business. These firms' stock trading activity is for a limited purpose and ancillary to their primary business handling stock-option orders on an options exchange of which they are member. Moreover, there is a close link between the stock component transaction of a stock-option order and the relevant options exchange. As such, the stock-option order exemption permits these types of firms to continue their stock-option order trading business without being required to join stock exchanges or an Association solely in order to effect the execution of the stock legs of stock-option orders that they handle.

As stated above, the Commission estimates that, in 2022, 48 of the 73 firms identified as registered broker-dealers and exchange members but not FINRA members initiated options order executions.[215] The Commission estimates that 17 of the firms that initiated options order executions also effected the execution of stock leg transactions, and therefore could potentially rely on the proposed stock-option order exemption to the extent that they effect the stock leg executions off-exchange or on an exchange where they are not a member.[216] Because the

[207] *See* Initial ITS Plan Approval Order, *supra* note 192.

[208] *Id.*

[209] *Id.*

[210] While there could be direct exchange SRO or FINRA oversight over the routing broker-dealer in this scenario, the Commission does not believe this is adequate, as discussed above, due to the lack of direct FINRA oversight over the broker-dealer initiating the order. *See supra* notes 98–101 and accompanying text (discussing that separate exchange SRO recourse against different broker-dealers for the same conduct can present the potential for inconsistent outcomes).

[211] Alternatively, a firm wishing to route orders to exchanges using a non-exchange-designated routing broker-dealer could comply with section 15(b)(8) by becoming a member of all exchanges to which it routes orders. But any such firm would still be required to join FINRA to the extent it effects off-exchange securities transactions (unless exempted by the stock-option order exemption). *See* section V.D, *infra.*

[212] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49947.

[213] *See id.*

[214] *See* Cboe Letter at 3 (stating that the existence of a stock-option exemption in the 2022 Re-Proposal is an acknowledgment that activity critical to the functioning of the options market should not be adversely impacted).

[215] *See supra* note 44.

[216] Source: CAT. The Commission previously estimated that, in 2021, seven such firms effected stock leg transactions and could potentially rely on the stock-option order exemption to the extent that they effect the stock leg transactions off-exchange or on an exchange where they are not a member. *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49947. The Commission attributes the increase from 2021 to 2022 of its estimated number of broker-dealers that are not FINRA members and that executed stock leg transactions mainly to an increase in the percentage of stock leg transactions that are captured in the CAT in a manner that enables the

broker or dealer relying on Rule 15b9–1(c)(2) would not itself be a member of an exchange on which such stock transactions are executed, or a member of an Association, such stock leg transactions must be effected with or through another registered broker or dealer that is a member of the exchange where the transactions are executed or a member of an Association (or both).

Options exchanges define the term ''stock-option order'' in their rules.[217] Further, the Commission stated in the 2022 Re-Proposal that its understanding is that all options exchanges accept a stock-option order only if it complies with the Qualified Contingent Trade (''QCT'') Exemption (''QCT Exemption'') from Rule 611(a) of Regulation NMS.[218] For purposes of relying on the exemption provided by Rule 15b9–1(c)(2), a broker or dealer should adhere to the stock-option order definition of the options exchange where the stock-option order is handled and of which the broker or dealer is a member.[219] Specifically, the broker or dealer could rely on that definition to determine whether, for purposes of amended Rule 15b9–1(c)(2), an order is in fact a stock-option order and a stock order is in fact the stock leg of a stock-option order. Moreover, the exemption applies regardless of whether the component legs of a stock-option order are executed electronically, on a physical exchange floor, or through a combination of both.

The Commission continues to believe, as discussed in the 2022 Re-Proposal, that the stock-option order exemption's reliance on the options exchange's ''stock-option order'' definition should enhance an exchange's ability to monitor whether its members are appropriately relying on the exemption and thereby enhance its ability to provide effective SRO oversight of its members' stock-option order trading activity. Under options exchange rules, an exchange member submitting a stock-option order to the exchange must designate to the exchange one or more specific broker-dealers: (i) that are not affiliated with the exchange; (ii) with which the exchange member has entered into a brokerage agreement; (iii) that the exchange has identified as having connectivity to electronically communicate the stock components of stock-option orders to stock trading venues; and (iv) to which the exchange will electronically communicate the stock component of the stock-option order on behalf of the member.[220] The option exchange's execution of the stock-option order is contingent on the exchange's receipt from the designated broker-dealer of an execution report for the stock component transaction confirming that the transaction has occurred.[221] In light of these rules, the Commission continues to believe that there is a close link between the stock component transaction of a stock-option order and the relevant options exchange. Accordingly, the Commission continues to believe that this exemption would serve the limited, narrowly defined purpose of facilitating the execution of stock-option orders consistent with options exchange rules and that the options exchange would be able to monitor and oversee the totality of the securities trading activity of any of its members that rely on the exemption.

The Commission also continues to believe that the exchange's oversight capabilities will be further enhanced, consistent with the public interest and protection of investors, by requiring brokers and dealers to develop written policies and procedures in connection with the stock-option exemption in paragraph (c)(2) of the amended rule. This requirement should help facilitate exchange SRO supervision of brokers and dealers relying on the stock-option order exemption because it would provide an efficient and effective way for the relevant options exchange to assess compliance with the exemption. Moreover, the Commission continues to believe that requiring brokers and dealers to develop written policies and procedures would provide sufficient flexibility to accommodate potentially varying business models of brokers and dealers that effect stock-option orders and may seek to rely on this exemption.

Such written policies and procedures must be reasonably designed to ensure and demonstrate that the broker's or dealer's securities transactions elsewhere than on an exchange of which it is a member are solely for the purpose of executing the stock leg of a stock-option order. Accordingly, a broker or dealer seeking to rely upon the stock-option order exemption must establish, maintain, and enforce written policies and procedures reasonably designed to ensure and demonstrate that such transactions are solely for the purpose of executing the stock leg of a stock-option order. For example, the broker or dealer could maintain documentation that demonstrates its compliance with the stock-option order requirements of any options exchange of which it is a member and where it effects the execution of stock-option orders. Indeed, in addition to the Commission, the options exchange of which the broker or dealer is a member and where the stock-option order is handled would be able to enforce compliance with the stock-option order exemption. In the context of routine examinations of its members, the options exchange generally would review the adequacy of its members' written policies and procedures and assess whether its members' off-member-exchange transactions comply with those written policies and procedures as well as the terms of the exemption itself, as set forth in amended Rule 15b9–1.[222]

Commission to identify the firms that initiated the transactions.

[217] *See, e.g.,* Cboe Rules 1.1 and 5.33(b)(5); MIAX Rule 518(a)(5); MIAX Emerald Rule 518(a)(5); Nasdaq Options 5, section 1(4) (defining ''Complex Trade''); Nasdaq PHLX Options 5, section 1(d) (defining ''Complex Trade''); Nasdaq ISE Options 5, section 1(d) (defining ''Complex Trade''); Nasdaq BX Chapter 5, section 27(a)(v)(1) of the ''Grandfathered Rules'' of the Boston Stock Exchange, Inc.; NYSE Arca Rule 6.62–O(h)(1); NYSE American Rule 900.3NY(h)(1).

[218] *See, e.g.,* Cboe Rule 5.33, Interpretations and Policies .04 Stock Option Orders; Supplementary Material .07 to Nasdaq ISE Options 3, section 14; Commentary .01 to MIAX Rule 518. A qualified contingent trade is ''a transaction consisting of two or more component orders, executed as agent or principal where: (1) at least one component order is in an NMS stock; (2) all components are effected with a product or price contingency that either has been agreed to by the respective counterparties or arranged for by a broker-dealer as principal or agent; (3) the execution of one component is contingent upon the execution of all other components at or near the same time; (4) the specific relationship between the component orders (*e.g.,* the spread between the prices of the component orders) is determined at the time the contingent order is placed; (5) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or since cancelled; and (6) the transaction is fully hedged (without regard to any prior existing position) as a result of the other components of the contingent trade.'' Securities Exchange Act Release No. 54389 (Aug. 31, 2006), 71 FR 52829 (Sept. 7, 2006); *see also* Securities Exchange Act Release No. 57620 (Apr. 4, 2008), 73 FR 19271 (Apr. 9, 2008).

[219] Presumably, an options exchange would accept only those stock-option orders that meet the exchange's definition thereof. In addition, the Commission's understanding is that, currently, consistent with options exchange definitions, a stock-option order contains only one stock leg. *See supra* note 217. Therefore, the stock-option order exemption currently covers stock-option orders with only one stock leg.

[220] *See, e.g.,* Cboe Rule 5.33(l) and Interpretations and Policies .04; Nasdaq ISE Options 3, section 7 and Supplementary Material .01, Options 3, section 14 and Supplementary Material .07; MIAX Rule 518 and Commentary .01.

[221] *See, e.g.,* Cboe Rule 5.33(l); Nasdaq ISE Options 3, section 7 and Supplementary Material .01, Options 3, section 14 and Supplementary Material .07; MIAX Rule 518 and Commentary .01.

[222] Section 19(g)(1) of the Act, 15 U.S.C. 78s(g), among other things, requires every SRO to examine for and enforce compliance by its members and associated persons with the Act, the rules and regulations thereunder, and the SRO's own rules, unless the SRO is relieved of this responsibility

Continued

Finally, a broker or dealer seeking to rely on the stock-option order exemption is required to preserve a copy of its policies and procedures in a manner consistent with Rule 17a–4 under the Exchange Act until three years after the date the policies and procedures are replaced with updated policies and procedures.[223] Accordingly, a broker or dealer is required to keep the policies and procedures relating to its use of this exemption as part of its books and records while they are in effect, and for three years after they are updated.

IV. Effective Date and Implementation

The Commission proposed that the compliance date for amended Rule 15b9–1 be one year after publication of any final rule in the **Federal Register**.[224] In proposing this compliance date, the Commission considered various factors that impact the time that it takes to become a FINRA member, as well as that firms that choose to adjust their business models such that they are not required to join FINRA would need time to do so.[225] The Commission understood that, on average, the FINRA membership application process takes approximately six months.[226]

Some commenters on the 2022 Re-Proposal characterized the FINRA membership application process as lengthy.[227] One commenter stated that it understood FINRA's membership application process to take more than a year, and suggested a revised compliance period in which firms must only submit their FINRA registration application within 360 days of adoption of amended Rule 15b9–1, and allow for 540 days from adoption for FINRA approval of the application.[228] FINRA stated that it typically has 180 days to issue a decision after the filing of a new membership application, but that, depending on the characteristics of an application, FINRA may issue a ''fast-track'' decision within 100 days.[229] FINRA also stated that, based on the types of proprietary trading dealer firms that would be likely to join FINRA as a result of the Rule 15b9–1 amendments, it intends to implement an expedited membership application process for these applicants pursuant to which it anticipates processing their applications within 60 days after submission.[230]

The Commission believes that a compliance date for amended Rule 15b9–1 that is 365 days after publication of amended Rule 15b9–1 in the **Federal Register** would provide a sufficient period of time for proprietary trading broker-dealer firms to comply with the amended rule. Based on FINRA's statements regarding its ability to issue a ''fast-track'' decision within 100 days and expectation that it would process proprietary trading dealer firm applications within 60 days after submission,[231] for any FINRA membership application submitted by such a firm in a timely manner, the Commission expects FINRA to be able to process the application and render a decision within the compliance period. Additionally, some commenters stated that the FINRA membership application process requires information that is duplicative of information already provided to the Commission and other SROs as part of their prior Commission registration and exchange SRO application process.[232] Accordingly, the Commission believes that when applying to be FINRA members, firms in this situation may be able to leverage their prior submissions to the Commission and exchange SROs to be able to have a more expedient application process with FINRA than they would otherwise if they had not already prepared such information for submission to the Commission and exchange SROs. More broadly, any existing broker-dealer firm that applies for FINRA membership as a result of the amendments to Rule 15b9–1 would have already completed the application processes for becoming a Commission-registered broker-dealer and a member of at least one exchange and, the Commission believes, should be able to leverage those experiences to expedite their application process with FINRA.

V. Economic Analysis

The Commission is amending Rule 15b9–1 to help ensure that an Association generally has direct, membership-based oversight over broker-dealers that effect off-member-exchange securities transactions and the jurisdiction to directly enforce their compliance with Federal securities laws, Commission rules, and Association rules. In addition, these amendments will provide a more consistent regulatory framework for broker-dealers,[233] which in turn should enhance competition and result in potential efficiency gains for market participants.

The Exchange Act's statutory framework places SRO oversight responsibility with an Association for trading that occurs elsewhere than on an exchange to which a broker or dealer belongs as a member.[234] However, currently pursuant to Rule 15b9–1, a broker or dealer may engage in unlimited off-member-exchange[235] proprietary trading without becoming a member of an Association, so long as its proprietary trading activity is conducted with or through another registered broker or dealer. Currently, off-exchange equity activity and exchange listed options trading of non-FINRA member broker-dealers is surveilled by FINRA through CAT data and supervised in part via the use of RSAs.[236] However, RSAs are voluntary, privately negotiated agreements that can expire or be terminated, and accordingly, these agreements do not provide the consistent and stable oversight that direct Association oversight of such trading activity does.[237] For example, of the current FINRA RSA contracts: one RSA contract expires at the end of 2023, seven RSA contracts expire at the end of 2024, and three RSA contracts expire at the end of 2025 unless extended or terminated early.[238] The amendments will provide consistency and stability of oversight.[239]

In the case of U.S. Treasury securities and other fixed income securities (other than municipal bonds)[240] that trade off-exchange, surveillance relies on TRACE data which is collected by FINRA from

pursuant to section 17(d), 15 U.S.C. 78q(d), or section 19(g)(2), 15 U.S.C. 78s(g)(2), of the Act.

[223] *See, e.g.,* 17 CFR 240.17a–4(e)(7).

[224] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49951.

[225] *Id.*

[226] *Id.*

[227] *See, e.g.,* FIA PTG Letter at 4–5; PEAK6 Letter at 2.

[228] *See* FIA PTG Letter at 4–5.

[229] *See* FINRA Letter at 12.

[230] *See id.* at 12–13.

[231] *See supra* notes 229–230 and accompanying text.

[232] *See* PEAK6 Letter at 2; FIA PTG Letter at 4.

[233] *See* section III.A, *supra.*

[234] *See* section I, *supra.*

[235] ''Off-member-exchange'' trading of securities refers to trading by a broker-dealer on any national securities exchange of which it is not a member or in the off-exchange market. *See supra* note 2 and accompanying text.

[236] *See* section V.A.2, *infra.*

[237] *See* sections I and III.A, *supra.*

[238] Based on information provided by FINRA.

[239] Current non-FINRA members that choose to join FINRA in response to the amendments will face direct Association oversight of their off-member exchange trading instead of oversight that occurs and is based on an RSA. The Exchange Act's statutory framework places SRO oversight responsibility with an Association for off-member-exchange securities trading, and FINRA's role with respect to non-FINRA member broker-dealers is limited to what is covered in RSAs it enters into with the exchanges. *See supra* section III for a discussion of issues related to RSA-administered oversight of off-member exchange trading.

[240] Municipal bond trades are reported to the MSRB but not TRACE, so the Commission does not expect the proposed amendments to affect the data collected on municipal bonds. Off-exchange trading of both listed and unlisted equities by non-FINRA member broker-dealers is already reported to CAT.

its members.[241] Some dealer firms that are not FINRA members are significantly involved in trading U.S. Treasury securities [242] proprietarily but are not required to report these transactions because they are not FINRA members. Consequently, trades that do not occur on an ATS or with a covered depository institution,[243] and that are between two non-FINRA member broker-dealers, are not reported to TRACE at all, and trades that occur otherwise than on a covered ATS do not specifically identify the non-FINRA member in the information reported by the ATS to TRACE.[244] The amendments will provide for all fixed income trading by broker-dealers to be subject to FINRA's rules, including its rules requiring reporting to TRACE.

Section 15(b)(8)'s complementary SRO oversight structure generally has enabled exchange SROs to specialize in oversight of securities trading activity that occurs on the exchange, and FINRA to specialize in oversight of off-member-exchange securities trading activity. The amendments will rescind the *de minimis* allowance and proprietary trading exclusion so that the regulatory scheme more appropriately effectuates Exchange Act principles regarding complementary exchange SRO and Association oversight.[245] For broker-dealers relying on the exemption that will be required to register with FINRA under the amendments, joining FINRA will expose these firms to additional costs that they previously did not incur.[246] While reliance on the exemption may be cost-efficient for these firms, it introduces inefficiencies for exchange SROs, FINRA, and regulatory oversight more generally. FINRA, the sole Association, has a rulebook, surveillance infrastructure, and supervisory expertise that is targeted to cross-exchange and off-exchange trading of both listed and unlisted securities. When FINRA detects potentially violative behavior by a non-FINRA member firm,[247] it can and does refer such cases to other SROs or the SEC. However, it may lack certain investigative tools which could help it further investigate potentially violative behavior before making such referrals. The Commission believes that, particularly in the case of fixed income trading, FINRA is well positioned to efficiently investigate such instances of violative behavior because of its TRACE data collection and expertise in such trading, and such a role is consistent with the SRO structure mandated by the Exchange Act.

The Commission discusses below a number of economic effects that are likely to result from the adoption of these amendments.[248] As discussed in detail below, the effects are quantified to the extent practicable. Although the Commission is providing estimates of direct compliance costs where practicable, the Commission also anticipates that brokers and dealers affected by the amendments, as well as competitors of those broker and dealers, might modify their business practices regarding the provision of liquidity in both off-exchange markets and on exchanges. Consequently, much of the discussion below is qualitative in nature, but where possible, the Commission has provided quantified estimates.[249] To the extent that non-FINRA member firms change their business practices, such as reducing or eliminating their off-member-exchange trading activity or joining FINRA and increasing their off-member-exchange activity, the amendments may impact competition and liquidity, particularly in the off-member-exchange markets. The adoption would increase costs for non-FINRA member firms that will have to register with FINRA, which might result in decreased liquidity provision by these non-FINRA member firms to certain markets. Additionally, the amendments to Rule 15b9–1 might create incentives for non-FINRA member firms that are impacted by the amendments to form a new Association. The creation of such a new Association would entail large startup costs but could spur competition with the existing Association and might lower general self-regulatory financial burdens. The amendments may also result in potential benefits to competition, since current FINRA members will be operating on a more level regulatory playing field relative to non-FINRA members.

A. Baseline

1. Regulatory Structure and Activity Levels of Non-FINRA Member Firms

The Exchange Act governs the way in which the U.S. securities markets and their brokers and dealers operate. Section 3(a)(4)(A) of the Act generally defines a ''broker'' broadly as ''any person engaged in the business of effecting transactions in securities for the account of others.'' [250] In addition, section 3(a)(5)(A) of the Act generally defines a ''dealer'' as ''any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise.'' [251] Generally, any broker-dealer that wants to interact directly on a securities exchange must register with the Commission as a broker-dealer before applying to gain direct access to the exchange,[252] and broker-dealers generally must become members of an Association to trade securities elsewhere than on an exchange to which

[241] Non-FINRA member depository institutions also report U.S. Treasury securities trades to TRACE. *See supra* note 123.

[242] The Commission can observe and quantify some of this activity through the reporting of U.S. Treasury securities on covered ATSs as discussed in *supra* section III.A. *See supra* note 59. It is likely that non-member broker-dealers also trade fixed-income securities other than U.S. Treasury securities and these transactions are also not reported to TRACE. This Economic Analysis focuses on the effects on equities, options, and U.S. Treasury securities markets. To the extent that non-FINRA member broker-dealers do trade in additional asset classes, the Commission believes that the economic impacts discussed herein would also apply. In particular, if a non-FINRA member broker-dealer does trade in an asset class which requires reporting to FINRA, the proposal would improve transparency for these securities, which would enhance the regulatory oversight of such activity. *See infra* section V.C.2.c for information on the costs of TRACE reporting for non-FINRA member firms.

[243] These trades do not include those with depository institutions that are mandated for TRACE reporting.

[244] *See* section III.A, *supra.* The Commission believes this is a small fraction of U.S. Treasury securities trading. In Apr. 2023, the Commission estimates that non-FINRA member broker-dealers' U.S. Treasury securities transactions executed on covered ATSs accounted for 2.65% of total U.S. Treasury securities transaction volume reported to TRACE that month. *See supra* note 57. The unreported trades involving only non-FINRA member firms that are not executed on covered ATSs might be similar but could be a lower fraction of the total U.S. Treasury securities volume.

[245] *See* section III.A, *supra.*

[246] FINRA member firms that compete with these firms may currently be at a cost disadvantage due to this fee disparity.

[247] The term ''non-FINRA member firm'' refers to a broker-dealer that is not a FINRA member.

[248] The Commission is sensitive to the economic effects of its rule, including the costs and benefits and effects on efficiency, competition, and capital formation. Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking pursuant to the Exchange Act, to consider or determine whether an action is necessary or appropriate in the public interest, and to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f). In addition, section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the effect such rules would have on competition. *See* 15 U.S.C. 78w(a)(2). Exchange Act section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

[249] *See infra* section V.B.1 for further discussion of the difficulties in estimating market quality effects likely to result from the amendments.

[250] 15 U.S.C. 78c(a)(4)(A).

[251] 15 U.S.C. 78c(5)(A).

[252] A firm that wishes to transact business upon an exchange without becoming a broker or dealer generally can do so by engaging a broker-dealer that is a member of that exchange to provide market access and settlement services.

a broker or dealer belongs as a member.[253]

There is diversity in the size and business activities of brokers and dealers. Carrying brokers and dealers hold customer funds and securities; some of these are also clearing brokers, which handle the clearance and settlement aspects of customer trades. In contrast, introducing brokers provide services to customers, but do not hold customers funds or execute or clear trades themselves. However, of 3,515 registered brokers and dealers, only 210 were classified as carrying or clearing brokers and dealers and around 1,200 firms were classified as introducing brokers at the end of 2022.[254] Thus, the majority of brokers and dealers engage in a wide range of other activities, which may or may not include handling customer accounts. These other activities include intermediating between customers and carrying/clearing brokers; dealing in government bonds; private placement of securities; effecting transactions in mutual funds that involve transferring funds directly to the issuer; writing options; acting as a broker solely on an exchange; and providing liquidity to securities markets, which includes, but is not limited to, the activities of registered market makers.

Sixty-six percent of brokers and dealers employ 15 or fewer associated persons and only 10% of brokers and dealers employ over 100 associated persons.[255] Further, while there are many registered brokers and dealers, a small minority of brokers and dealers controls the majority of broker and dealer capital.[256]

The Commission has identified 64 firms that, as of April 2023, were Commission registered broker-dealers and exchange members, but not members of FINRA, that may be required to either join an Association or change their trading practices under the amendments.[257] In September 2022, there were 73 registered broker-dealers that were exchange members but not FINRA members.[258] Because of Rule 15b9–1's exclusion of proprietary trading, a dealer that had not carried customer accounts might not be required to join an Association as long as it had been a member of an exchange SRO, even when that dealer had substantial off-member-exchange trading activity.

The Commission is aware that some non-FINRA member firms trade U.S. Treasury securities. Covered ATSs report the U.S. Treasury securities trading activity of non-FINRA member firms to TRACE. The Commission estimates that, in 2022, seven of the 64 non-FINRA member firms had $6 trillion in U.S. Treasury securities volume reported to TRACE by covered ATSs. This accounts for approximately 3.67% of U.S. Treasury volume as reported to TRACE throughout the year. In April 2023, there were five non-FINRA member firms with approximately $302 billion in U.S. Treasury securities volume executed on covered ATSs or approximately 2.65% of total U.S. Treasury securities transaction volume reported to TRACE that month.

FINRA members are required to report transactions in TRACE-eligible securities. Market participants can gain real-time access to TRACE through market vendors, for most TRACE-eligible securities, with a few exceptions including U.S. Treasury securities.[259] However, FINRA does make public aggregate U.S. Treasury securities data on a daily basis.[260] Non-FINRA member firms are not required to report their trading activity to TRACE, but if their transactions involve FINRA members or covered depository institutions, the FINRA members or covered depository institutions would report. With respect to trading activity in U.S. Treasury securities markets on a covered ATS, non-FINRA member counterparties are identified in TRACE.[261] With respect to trading activity in other TRACE-eligible securities, non-FINRA member counterparties are not identified in TRACE.[262] Therefore, the Commission is unable to estimate the level of trading activity of non-FINRA member firms for other fixed income securities.

In September 2022, of the 73 non-FINRA member firms, 53 initiated equity orders that were not executed on an exchange, accounting for $440 billion (approximately 5.1%) in off-exchange traded dollar volume in listed equities.[263] In April 2023, of the 64 non-FINRA member firms, 45 initiated equity orders that were not executed on an exchange, accounting for $405 billion (approximately 5.6%) in off-exchange traded dollar volume in listed equities.

There is significant diversity in the business models of non-FINRA member firms. Some non-FINRA member firms may limit their equity trading to a single exchange, while others trade on multiple venues including off-exchange venues such as ATSs. Some firms are significant contributors to both off-exchange and exchange volume. Because CAT requires reporting of all NMS stock trades, including off-exchange trades, FINRA and the Commission are able to quantify the aggregate off-exchange activity of non-FINRA member firms in NMS stocks.

Off-exchange equity trading occurs across many trading venues. In the fourth quarter of 2022, 32 ATSs actively traded NMS stocks, comprising 10.5% of NMS stock share volume. Furthermore, 214 named[264] broker-dealers transacted a further 32.4% of NMS stock share volume off-exchange without the involvement of an ATS. Although many market participants provide liquidity within this market, non-FINRA member firms are particularly active within ATSs.[265]

While some non-FINRA member firms trade actively cross-exchange and/or off-exchange, some of these firms also supply and demand liquidity actively on multiple equity and options exchanges. Table 1 below shows the executed dollar volume in listed equities by trading venue type during September 2022 and April 2023 for the non-FINRA member firms. Table 2

[253] *See supra* note 19.

[254] Based on the number of firms that answered yes to items I8084 or I8085 on Schedule I in December 2022. The number of introducing broker dealers was estimated from the question ''Does applicant refer or introduce customers to any other broker or dealer?'', as reported on Form BD.

[255] Based on Dec. 2022 Annual FOCUS data filings. *See also supra* note 150.

[256] *See infra* section VII.

[257] Historically, floor brokers had only incidental trading on exchanges of which they were not members and limited off-exchange trading activity. The background and history of Rule 15b9–1 are discussed in section I.

[258] *See supra* note 37. Some commenters, citing the Commission's proposal to amend the definition of ''dealer,'' stated that number of firms affected by the amendments to Rule 15b9–1 could increase if the definition of ''dealer'' is amended. *See, e.g.,* STA Letter at 2. The economic analysis appropriately considers existing regulatory requirements, including recently adopted rules but not proposed rules, as part of its economic baseline against which the costs and benefits of the final rule are measured. To the extent the Commission amends the definition of ''dealer'' in the future, the adopted amendments to Rule 15b9–1 would become part of the baseline from which the effects of any such new rule on the definition of ''dealer'' are measured. *See supra* note 186 and accompanying text.

[259] *See* Stephanie Dumont & Ola Persson, *TRACE at 20—Reflecting on Advances in Transparency in Fixed Income* (FINRA.org), Jun. 28, 2022, *available at https://www.finra.org/media-center/blog/trace-at-20-reflecting-advances-transparency-fixed-income* (last visited July 20, 2023). *See also* FINRA Rule 6750(c).

[260] *See supra* note 122 and accompanying text.

[261] *See supra* note 124 and accompanying text.

[262] FINRA stated that it does not have visibility into the activity of PTFs in non-U.S. Treasury security fixed-income products. *See* FINRA Letter at 9.

[263] *See supra* section II.B for further discussion of trading activities of non-FINRA member firms.

[264] ATSs report counterparties that are not FINRA members, allowing such activity to be identified in CAT data.

[265] *See* Table 1 for information on trading activities on ATSs.

below shows the executed dollar volume, number of trades, and number of contracts in options during September 2022 and April 2023 for the non-FINRA member firms.

TABLE 1—NON-FINRA MEMBERS NMS EQUITY TRADING VOLUME BY VENUE TYPE

	Traded dollar volume			
	Sept 2022		April 2023	
	Billions ($)	% of total	Billions ($)	% of total
I. All Non-FINRA Member Firms [1]				
Trading Venue:				
Off-Exchange: ATS	369.59	12.6	352.38	14.6
Off-Exchange: Non-ATS	70.63	2.4	52.41	2.2
On-Exchange: Exchange Member [2]	2,183.14	74.4	1,746.53	72.4
On-Exchange: Not Exchange Member	311.62	10.6	261.91	10.9
Total	2,934.98	100.0	2,413.23	100.0
II. Largest Non-FINRA Member Firms [3]				
Trading Venue:				
Off-Exchange: ATS	333.48	14.6	322.16	16.1
Off-Exchange: Non-ATS	57.60	2.5	41.62	2.1
On-Exchange: Exchange Member [2]	1,639.34	71.9	1,415.99	70.8
On-Exchange: Not Exchange Member	248.40	10.9	219.46	11.0
Total	2,278.82	100.0	1,999.22	100.0

Data Source: CAT.

[1] Non-FINRA Member firms that initiated NMS equity orders that were executed either on or off-exchange. There were 53 firms in September 2022 and 45 firms in April 2023.

[2] Exchange Member refers to trades executed on an exchange where the non-FINRA member is a registered member.

[3] The largest 12 non-FINRA member firms ranked by equity off-exchange traded dollar volume.

TABLE 2—NON-FINRA MEMBERS OPTIONS TRADING VOLUME BY VENUE TYPE

	Traded dollar volume			
	Sept 2022		April 2023	
	Billions ($)	% of total	Billions ($)	% of total
Panel A: Option Dollar Volume				
I. All Non-FINRA Member Firms [1]				
Trading Venue:				
On-Exchange: Exchange Member [2]	50.01	93.8	44.62	94.4
On-Exchange: Cross-Exchange [3]	3.31	6.2	2.65	5.6
Total	53.33	100.0	47.27	100
II. Largest Non-FINRA Member Firms [4]				
Trading Venue:				
On-Exchange: Exchange Member [2]	45.56	94.2	40.43	94.3
On-Exchange: Cross-Exchange [3]	2.80	5.8	2.44	5.7
Total	48.37	100.00	42.87	100
	Trades			
	Sept 2022		April 2023	
	Millions	% of total	Millions	% of total
Panel B: Number of Option Trades				
I. All Non-FINRA Member Firms [1]				
Trading Venue:				
On-Exchange: Exchange Member [2]	18.41	94.8	19.60	95.4
On-Exchange: Cross-Exchange [3]	1.00	5.2	0.95	4.6
Total	19.41	100	20.55	100
II. Largest Non-FINRA Member Firms [4]				
Trading Venue:				
On-Exchange: Exchange Member [2]	16.41	95.4	17.09	95.8

TABLE 2—NON-FINRA MEMBERS OPTIONS TRADING VOLUME BY VENUE TYPE—Continued

	Traded dollar volume			
	Sept 2022		April 2023	
	Billions ($)	% of total	Billions ($)	% of total
On-Exchange: Cross-Exchange [3]	0.79	4.6	0.75	4.2
Total	17.20	100	17.84	100
	Contracts			
	Sept 2022		April 2023	
	Millions	% of total	Millions	% of total
Panel C: Number of Option Contracts				
I. All Non-FINRA Member Firms [1]				
Trading Venue:				
On-Exchange: Exchange Member [2]	147.31	94.5	179.13	95.6
On-Exchange: Cross-Exchange [3]	8.58	5.5	8.20	4.4
Total	155.88	100.0	187.34	100.0
II. Largest Non-FINRA Member Firms [4]				
Trading Venue:				
On-Exchange: Exchange Member [2]	129.67	95.1	158.01	96.0
On-Exchange: Cross-Exchange [3]	6.66	4.9	6.62	4.0
Total	136.33	100.0	164.64	100.0

Data Source: CAT.

[1] Non-FINRA Member firms that initiated options orders that were executed. There were 53 firms in September 2022 and 45 firms in April 2023. While these are the same numbers of non-FINRA member firms that initiated NMS equity orders as reflected in Table 1, they are not all the same firms as there is not 100% overlap. Some firms that initiated NMS equity orders did not initiate options orders. Some firms that initiated options orders did not initiate NMS equity orders. The number of firms in these two groups is the same.

[2] Exchange Member refers to trades executed on an exchange where the non-FINRA member is a registered member.

[3] Cross-Exchange refers to trades executed on an exchange where the non-FINRA member is not registered member.

[4] The largest 12 non-FINRA member firms ranked by equity off-exchange traded dollar volume. Nine of the largest 12 firms in September 2022 and eleven of the largest 12 firms in April 2023 initiated options orders that were executed.

Table 1 shows that in April 2023 non-FINRA member firms executed approximately 72.4% of their NMS equity trading volume on exchanges where the firm was a registered member. However, they also transacted on exchanges where the firm was not a member in addition to trading off-exchange. Table 2 shows data for non-FINRA member firms that also executed trades in the options market and their total dollar, trades, and contract volume. In September 2022, 53 non-FINRA member firms and nine of the 12 largest firms [266] executed trades on options exchanges. Seven of the nine largest firms executed trades on five or more options exchanges. In April 2023, 45 non-FINRA member firms and eleven of the 12 largest firms executed trades on options exchanges.

Table 2 indicates that a larger share of options trading by non-FINRA members (relative to equities trading) takes place on exchanges wherein the firm is a registered member, ranging from 94%–96%. Therefore, about 5% of non-FINRA member options trading occurs on exchanges where the firm is not a member, the volume of which accounts for around 1% of overall options trading volume.[267]

One commenter indicated that because non-FINRA members' off-member-exchange transactions represent a relatively small proportion of total options market volume, mandating FINRA membership will not promote regulatory efficiency, since (in the commenter's assessment) the costs of Association membership will exceed any benefits provided by FINRA oversight of ''a relatively small amount of trading activity, especially if this activity is already being conducted through a FINRA broker-dealer.'' [268] The Commission, however, believes that the benefits stemming from Association oversight of these flows are not trivial and justify their accompanying costs. More specifically, while the Commission agrees that off-member-exchange options volume is not large relative to the size of the overall options market, it is nonetheless economically large, representing between $133 to $165 million of daily options dollar volume.[269]

2. Current Market Oversight

The surveillance and regulation of each broker or dealer is partially dependent upon its individual SRO

[266] The largest non-FINRA member firms are ranked by equity off-exchange traded dollar volume. Nine of the largest 12 firms in September 2022 and eleven of the largest 12 firms in April 2023 initiated options orders that were executed.

[267] *See* note 269, *infra.*

[268] The commenter stated that the proposed rule would not promote regulatory efficiency, since the costs of FINRA membership would be disproportionate to gains from membership. *See* CTC Letter at 4. Consideration of costs and benefits of the amendments are presented in section V.C.

[269] More specifically, in September 2022, 53 of the 73 non-FINRA member firms initiated options orders that were executed off-member-exchange, valued at $3.31 billion and equal to about 0.3% of total options market volume. In April 2023, 45 of the 64 non-FINRA member firms initiated options orders that were executed off-member-exchange, valued at $2.65 billion, approximately 0.4% of total options market volume. *See supra* Table 2 for additional detail. One commenter raised a similar concern regarding the equities market. *See* STA Letter at 3. As equities trading represents a much larger portion (more than 25%) of non-FINRA member volume relative to options trading, the Commission views an even greater need for FINRA supervision in equities markets.

membership status. Each SRO is required to examine for and enforce compliance by its members and associated persons with the Exchange Act, the rules and regulations thereunder, and the SRO's own rules, including, for exchange SROs, the rules on the trading that occurs on the exchange. Exchange SROs generally possess expertise in supervising members who specialize in trading on their exchange and in using the order types that may be unique or specialized on the exchange. This expertise complements the expertise of an Association in supervising off-member-exchange trading activity.[270]

In the markets for NMS equities and listed options, while all exchanges are SROs and have access to CAT data covering trading activity by their members both on and off exchanges, nearly all cross-market and off-exchange equity activity and much options activity of non-FINRA member broker-dealers is surveilled by FINRA through RSAs with exchange SROs. However, RSAs are voluntary, privately negotiated agreements that can expire or be terminated, and accordingly, these agreements may not in the future provide the consistency and stability of direct FINRA oversight. U.S. Treasury security trading and other fixed income trading,[271] however, is not covered by CAT; instead transactions in these securities are only reported to FINRA's TRACE database when there is a FINRA member or covered depository institution that is party to the trade or the trade occurs on an ATS because such reporting results from a FINRA rule.[272] Where no FINRA member or covered depository institution is party to the transaction, and the transaction does not take place on an ATS, it goes unreported to TRACE.[273]

Some exchanges serve as DEA for certain of their members.[274] Financial and operational requirements share many commonalities across SROs, such as net capital requirements and books and records requirements. Because many brokers and dealers are members of multiple SROs with similar requirements, one SRO is appointed as the broker's or dealer's DEA to examine common members for compliance with the financial responsibility requirements imposed by the Act, or by Commission or SRO rules.[275] The exchange serving as DEA has regulatory responsibility for their common members' compliance with the applicable financial responsibility rules.[276] However, the non-DEA exchange maintains responsibility for compliance with its own rules and provisions of the Federal securities laws governing matters other than financial responsibility, including sales practices and trading activities and practices, although the SROs may also allocate other regulatory responsibilities.

All registered brokers and dealers are required to join an Association unless they effect transactions in securities solely on a national securities exchange of which they are a member or are exempt from the membership requirement pursuant to Rule 15b9–1. The vast majority of broker-dealers join an Association and, because FINRA is the only Association, broker-dealers are subject to relatively uniform regulatory requirements and levels of surveillance and supervision for their activities overseen by FINRA. Supervision by FINRA covers a market that is fragmented across many trading venues, including the more opaque off-exchange market.[277] Additionally, FINRA oversees its members' activity in equity, fixed income, and derivative markets and thus has the ability to surveil asset classes that may be outside the expertise of certain exchange SROs (*e.g.,* options exchanges may lack expertise in fixed income securities).[278]

The existing Association, FINRA, serves crucial functions in the current regulatory structure.[279] The Exchange Act's statutory framework generally places responsibility for off-member-exchange trading with an Association.[280] Accordingly, FINRA has established a regulatory regime for FINRA members, including FINRA members conducting business in the off-member-exchange market for various asset classes, and developed surveillance technology and specialized regulatory personnel to provide surveillance, supervision, and enforcement of activity occurring off-member-exchange. Consequently, the current regulatory structure achieves off-member-exchange supervision through the surveillance actions of FINRA of the market generally and its examination of its members.

Additionally, despite the fact that FINRA does not have jurisdiction over non-FINRA member firms or provide regulatory oversight services to non-FINRA member firms that are not covered by RSAs, FINRA surveils 100% of the equities and options markets with CAT data as well as other data sources.[281] Moreover, where it identifies potential concerns relating non-FINRA member firms' activities, FINRA refers cases for enforcement to the SRO with jurisdiction or to the Commission. If FINRA is performing regulatory services for an exchange SRO pursuant to an RSA, FINRA may, on behalf of the exchange SRO, investigate and bring an enforcement action against an exchange SRO member that is not a FINRA member, assuming that those services are covered by the RSA.[282] However, each RSA is independently negotiated and thus not standardized. Therefore, FINRA's ability to provide oversight can vary based on the nature of its RSA with the exchange SRO. Additionally, the ultimate responsibility for that regulatory oversight under an RSA still rests with the exchange SRO, not with FINRA.[283] SROs may also use 17d–2 plans which allow SROs with common members to designate a single SRO to

[270] *See supra* section II, discussing the requirement for SROs to examine for and enforce compliance with the Exchange Act, and the rules and regulations thereunder.

[271] Municipal bond trades are not reported to TRACE. *See supra* note 240.

[272] All ATSs are operated by FINRA member firms.

[273] These reporting gaps were noted by FINRA, which indicated that it could not identify non-FINRA member firm transactions in U.S. Treasury securities that do not occur on a covered ATS. Similarly, FINRA stated that it has no visibility into the activity of non-member firms in transactions of non-U.S. Treasury fixed income securities. *See* FINRA Letter at 9. Beginning in Sept. 2022, FINRA began collecting transactions by certain banks in government securities. *See supra* note 123.

[274] *See supra* note 13.

[275] *See supra* note 13. *See* 17 CFR 240.17d–1. FINRA serves as the DEA for the majority of member firms; there are exceptions, mostly involving firms that have specialized business models that focus on a particular exchange that is judged to be best situated to supervise the member firm's activity. These firms are, however, subject to the same supervision of their trading activity as other member firms for which FINRA does act as DEA, and the DEA stipulates which SRO has responsibility to supervise the firm but does not allow for less supervision.

[276] Under the amendments, non-FINRA member firms that join FINRA may or may not be assigned to FINRA for DEA supervision. *See supra* section III.A.

[277] Comprehensive reporting requirements for all member firms that trade equities off-exchange give FINRA information on market activity levels and market conditions off-exchange. Because most off-exchange equity trading venues do not publicly disseminate information on the liquidity available in their systems, comprehensive information from all participants through CAT allows FINRA to analyze and surveil the off-exchange market. *See supra* note 17.

[278] For example, FINRA has extensive specific rules and dedicated staff applicable to fixed income markets. *See* FINRA.org, Key Topics: Fixed Income, *available at https://www.finra.org/rules-guidance/key-topics/fixed-income.*

[279] *See supra* section II for further discussion of the role of Associations in market oversight.

[280] *See supra* note 26.

[281] CAT data is available to all SROs. FINRA utilizes other data sources for their surveillance as well as CAT data.

[282] In most but not all cases, FINRA is empowered to take such actions.

[283] *See supra* note 84.

examine common members. However, 17d–2 plans do not confer jurisdiction to FINRA as they apply only to common firms of which each SRO would already have jurisdiction.[284] Exchange SROs may not be efficient, relative to FINRA, at monitoring off-member-exchange activity.

Some non-FINRA member firms trade significantly in the course of their normal business activities on exchanges of which they are not members. This activity is not limited to equities and options; non-FINRA member firms play a large role in U.S. Treasury securities markets as well.[285] In 2022, there were seven non-FINRA member firms that together traded more than $6 trillion in U.S. Treasury securities volume on covered ATSs, which accounted for 3.67% of total U.S. Treasury securities trading volume [286] reported to TRACE. The Commission estimates that in April 2023, five non-FINRA member firms totaled $302 billion in U.S. Treasury securities volume executed on covered ATSs, accounting for 2.65% of total U.S. Treasury securities transaction volume reported to TRACE that month.

This is very different from when Rule 15b9–1 was first adopted, when firms' exchange activity typically was a floor business conducted on a single national securities exchange.[287] While the Act provides for regulation of exchange trading by the exchanges themselves, it additionally grants regulatory oversight of off-exchange trading by an Association.[288] FINRA, currently the sole Association, has specific tools and expertise to provide oversight to off-exchange activity. However, FINRA's regulatory jurisdiction is limited to its membership.

Some commenters have suggested that the current regulatory structure already subjects non-FINRA member firms to robust SRO oversight because exchange SROs have access to both on- and off-member-exchange equity and options trading data of their members via CAT.[289] Indeed, SRO rules require their members to report CAT data daily.[290] One commenter noted that this has helped dramatically improve the ability of regulators to identify violative activity which is initiated off-member-exchange, across both the equity and options markets.[291]

Some commenters also stated that option exchange SROs have specialized expertise that makes them well suited for effectively overseeing options trading.[292] In addition, one commenter stated that there are existing mechanisms for SROs to coordinate surveillance of cross-exchange options trading, such as the ISG and its subgroups.[293] The commenter further stated that the ISG ''provides a nonexclusive forum for discussions and referrals to occur and/or to coordinate on matters of joint interest to its members, while preserving each SRO's independent decision-making and enforcement authority.'' However, with regard to off-member-exchange activity, which in the case of options firms, also includes equity trading activity, SRO oversight is based on RSAs, which are subject to certain limitations. For example, RSAs can expire or be terminated.[294]

Some commenters stated that non-FINRA member off-member-exchange activity is frequently conducted through FINRA member broker-dealers,[295] and is therefore already accessible to FINRA surveillance. However, trading through FINRA members does not confer direct authority to FINRA over these non-members. This is relevant given that FINRA stated that it identified non-member firms as potential respondents in five percent of its 2020 and 2021 market regulation investigations.[296] In addition, FINRA stated that ''for certain products and exchanges, some non-member firm conduct may not fully be subject to exchange rules that provide for important protections in connection with the execution of customer orders (*e.g.,* not all exchanges have comparable best execution rules).'' [297]

Non-FINRA member firms that are exempt from the Exchange Act's Association membership requirement are not required to pay the costs of Association membership, which might be significant, especially for firms with substantial trading activity (*e.g.,* they would incur TAF and other expenses if they chose to join FINRA in response to the amendments). Fees associated with FINRA membership include the annual Gross Income Assessment (GIA), the annual personnel assessment, and the TAF and section 3 fees.[298] FINRA members pay the TAF for all sales transactions of covered securities that are not performed in the firm's capacity as a registered specialist or market maker upon an exchange.[299] In particular, transactions in U.S. Treasury securities are not part of the ''covered securities'' for the purpose of TAF fee. FINRA members also must pay Transaction Reporting Fees for TRACE reportable securities, with the exception of U.S. Treasury securities.

The FINRA section 3 fee is the second of two primary FINRA fees (the other being TAF) that are assessed upon each transaction by or through a FINRA member. Under section 31 of the Act,[300] SROs must pay transaction fees based on the volume of their covered sales. These fees are designed to offset the costs of regulation incurred by the government—including the Commission—for supervising and regulating the securities markets and securities professionals. FINRA obtains money to pay its section 31 fees from its membership, in accordance with section 3 of Schedule A to the FINRA By-Laws. FINRA assesses these section 3 fees on the sell side of each off-exchange trade, when possible. When the sell side of a transaction is a non-FINRA member firm and the seller engages the services of a clearing broker that is a member firm, FINRA can assess the section 3 fee against the member firm clearing broker.[301] When the seller is a non-FINRA member firm that self-clears, FINRA has no authority to assess the section 3 fee against the seller. In such case, FINRA would seek to assess the fee against the buyer, if the buyer

[284] *See supra* note 13.

[285] *See supra* section V.A.1 and accompanying text for more information on trading in U.S. Treasury securities markets.

[286] The Commission estimates from 2023 TRACE data that in Apr. 2023 there were 916 total firms that traded U.S. Treasury securities.

[287] *See* 2022 Re-Proposal, *supra* note 1, 87 FR 49932; *see also* Qualifications and Fees Release, *supra* note 33.

[288] *See supra* note 66.

[289] *See, e.g.,* Cboe Letter at 2; ABCV Letter at 3; CTC Letter at 3; Group One Letter at 1; MMI Letter at 2; PEAK6 Letter at 2.

[290] These data record the origination, receipt, execution, routing, modification, or cancellation of every order a member firm handles for NMS stocks and options, with the exception of primary market transactions. *See generally* FINRA Rule 6800 Series and 17 CFR 242.613.

[291] *See* STA Letter at 2.

[292] *See* ABCV Letter at 3; Cboe Letter at 6; FIA PTG Letter at 2. Commenters also stated that options exchanges surveil the equities trading of their members. However, non-FINRA members conduct 15 to 17 percent of equity trades off-exchange, instances where FINRA surveillance is more efficient than exchange SROs. *See supra* Table 1.

[293] *See* Nasdaq Letter at 3.

[294] *See supra* notes 237–238.

[295] *See* Cboe Letter at 3; CTC Letter at 5; Group One Letter at 2; PEAK6 Letter at 4.

[296] *See* FINRA Letter at 5.

[297] *See id.* at 7–8.

[298] *See infra* section V.C.2.b. for more information on these fees.

[299] Covered securities include all equity, options, and U.S. Treasury securities. For an explanation of what is included and exempt from the TAF, *see* FINRA Rules and Guidance, *available at https://www.finra.org/rules-guidance/rulebooks/corporate-organization/section-1-member-regulatory-fees.* After the 2022 Re-proposal, FINRA proposed an amendment that would exempt from the TAF transactions executed by proprietary trading firms on an exchange of which the firm is a member. *See* TAF Amendment, *supra* note 146.

[300] 15 U.S.C. 78ee.

[301] The seller's clearing broker may pass that fee on to the non-FINRA member firm.

includes a member firm counterparty or a member firm acting as clearing broker for a non-FINRA member firm buy side counterparty. Any broker-dealer that carries customer accounts is required to be a member of an Association and thus bear the aforementioned fees. These costs may be passed on in part or in whole to the investing public or the non-FINRA member counterparty.

3. Current Competition To Provide Liquidity

The market for liquidity provision on equity and options exchanges is competitive. In September 2022 across all exchanges, each equity security had a registered market maker providing liquidity, and some had as many as 48 registered market makers. The median equity security had 4 registered market makers and twenty-five percent of equity securities had 5 or more registered market makers. Sixty percent of equity securities have at least two registered market makers and forty percent had one registered market maker. In addition to these registered market makers, the Commission believes that other market participants effectively provide liquidity in equity securities through their trading activities. In the options market, each exchange had as many as 24 market makers providing liquidity. The average number of market makers per options security across exchanges is approximately 5.9. While counting the number of market makers does not necessarily indicate whether each market maker is an active competitor, it does provide a good indication as to the number of firms in the business of providing liquidity, and the Commission believes that many market makers do actively compete, both with other registered market makers and market participants generally, to provide liquidity.

As stated above, non-FINRA member firms do not have the same regulatory costs as FINRA member firms, which may give non-FINRA member firms a competitive advantage in providing liquidity in equities, options, and fixed income markets.[302] As such, non-FINRA member firms may be able to provide liquidity at a lower cost than FINRA member firms given that non-FINRA member firms have a lower variable cost, all else equal, for trading compared to FINRA member firms.

The Commission believes that non-FINRA member firms are active participants in the market to provide liquidity in off-exchange markets. The Commission estimates that non-FINRA member firms account for between 5.1% and 5.6% of off-exchange dollar volume in equities from September 2022 through April 2023. Additionally, nearly 16.8% of all non-FINRA member equity trading activity occurs in off-exchange markets. Approximately 5.0% of non-FINRA member options trading activity involves a non-member exchange. In U.S. Treasury securities markets, non-FINRA broker-dealer trading activity that is reported by covered ATSs accounts for 3.67% of all transaction volume.

B. Effects on Efficiency, Competition, and Capital Formation

In addition to the specific, individual benefits and costs discussed below, the Commission expects the amendments might have varying effects on efficiency, competition, and capital formation. These potential effects are described in this section. The amendments will likely result in improved efficiency of capital allocation. To the extent that liquidity provision changes as a result of the amendments, market efficiency might be impacted. Additionally, the amendments will have mixed effects on competition to provide liquidity, as current non-FINRA member firms might be less likely to provide liquidity but current FINRA members may be more likely to provide liquidity. The Commission believes that the amendments would not likely have a meaningful effect on capital formation.

1. Firm Response and Effect on Market Activity and Efficiency

Although non-FINRA member firms could achieve compliance with the amendments in multiple ways, each route might involve changes to firms' business models. Some non-FINRA member firms might limit their trading to exchanges of which they are members, and the Commission believes that some may not trade off-member-exchange other than to comply with Rule 611 of Regulation NMS or the Options Linkage Plan,[303] or to execute the stock leg of a stock-option order.[304] These firms would remain exempt from the requirement to become a member of an Association, if they comply with section 15(b)(8) of the Act or the rule as amended.[305] Other firms would no longer be exempt, and would need to take action to comply with the amended rule. Under the amended rule, a non-FINRA member firm that trades equities, options, or fixed income securities off-exchange, or upon exchanges of which it is not a member, can comply in at least four ways. The first option would be to join an Association. The second option would be to join all exchanges upon which the non-FINRA member firm wishes to trade, and to cease any off-exchange trading, other than off-member-exchange trading consistent with the routing exemption and stock-option order exemption. Third, a non-FINRA member firm could comply by trading solely upon those exchanges of which it is already a member, consistent with the statutory exemption in section 15(b)(8).[306] Finally, a non-FINRA member firm could cease trading securities entirely.

The changes non-FINRA member firms make to their business model to comply with the amendments may affect competition in the equity, options, and fixed income securities markets, particularly for off-member-exchange liquidity provision.[307] The Commission believes that the amendments will result in a more level regulatory playing field between current FINRA and non-FINRA members, as well as enhanced oversight and transparency of the markets in which these firms compete. In response, it is possible that current FINRA member firms might choose to commit additional capital to liquidity provision when the trading environment has more uniform regulatory requirements. If this results in an increased overall commitment of liquidity both to exchanges and the off-exchange market, there are likely to be positive effects on capital market efficiency, such as lower quoted spreads on exchanges. In addition to lowering immediate execution costs on exchanges, lower exchange quoted spreads are likely to reduce transaction costs off-exchange as well, because off-exchange trades are typically priced with reference to quoted exchange prices.

The amendments may result in improved efficiency of capital allocation

[302] One commenter agreed that the amendments ''will safeguard against certain market participants, in this case high-frequency trading firms, from retaining a competitive advantage in the market due to outdated regulations.'' *See* Better Markets Letter at 8.

[303] *See supra* section III.B.1.

[304] *See supra* section III.B.2.

[305] Changes to the exclusion are discussed in section III.B, *supra.*

[306] 15 U.S.C. 78*o*(b)(8).

[307] This sentiment was echoed by one commenter who stated that FINRA registration ''represents a significant barrier to entry'' for market making firms. *See* Group One Letter at 3. Some proprietary trading firms, however, are already members of FINRA. As a result, FINRA has experience addressing these issues regarding registration barriers by facilitating new members' registration processes. Additionally, the rule amendments would provide FINRA and the Commission with greater visibility into the activities of these firms.

by the financial industry.[308] While the Commission acknowledges that FINRA membership could act as an entry deterrent to new proprietary trading firms, there are benefits to ensuring a certain level of oversight for proprietary trading firms. The Commission believes that the adopted amendments to Rule 15b9–1 are consistent with the Exchange Act's statutory framework for complementary exchange SRO and Association oversight of broker-dealer trading activity and thus to the extent such firms are required to register with FINRA as a result of the amendments, the Commission believes that the costs are justified by the benefits of regulatory oversight.

While the amendments might reduce the capital commitment of non-FINRA member firms to liquidity provision, the Commission believes these effects are not likely to be significant because the market to provide liquidity is very competitive. These markets are served by a number of liquidity providers with different business strategies and a strategic change by relatively few competitors is unlikely to disturb liquidity provision overall. Additionally, any subsequent removal of liquidity from the market may improve execution quality on off-exchange markets.[309] Some institutional investors transacting in off-exchange markets might seek institutional investor counterparties and avoid transacting with proprietary trading firms. To this extent, the removal of non-FINRA member firm liquidity might be seen as improving liquidity quality within ATSs by some institutional investors.[310]

It is also possible that reducing the activity of non-FINRA member firms within ATSs might result in more ATS liquidity if non-FINRA member firms are acting as net takers of liquidity within these systems.[311] At a minimum, liquidity levels in ATSs may change. In addition, these firms may reduce their off-exchange trading outside of ATSs such as on single-dealer platforms. If this occurs, it is possible that this will result in a transfer of volume from off-exchange venues to exchanges, but it is also possible that overall market trading volume will diminish if decreased volume from off-exchange trading does not migrate to exchanges.[312] The Commission acknowledges that non-FINRA member firms, in response to the amendments, may become less willing to compete to provide liquidity off-member-exchange, decreasing liquidity off-exchange and on exchanges where such firms are not members. For example, non-FINRA member firms may choose to cease their off-member-exchange activity rather than join an Association—although it is likely that firms that trade heavily off-member-exchange may find it more costly to cease their off-member-exchange activity than to join an Association.[313] In addition, non-FINRA member firms that choose to join an Association may reduce their off-member-exchange trading because joining an Association would increase variable costs to trade in the off-member-exchange market, as these trades would incur section 3 and possibly additional fees, although some section 3 fees may already be passed on from FINRA member firms to non-FINRA member firms.[314] An increase in costs would reduce the profitability of off-member-exchange trading and thus potentially reduce aggregate off-member-exchange trading.

The Commission believes that required membership in an Association, consistent with section 15(b)(8) of the Act and amended Rule 15b9–1, could facilitate an appropriate level of oversight. The Commission also recognizes that the loss of liquidity provision in off-member-exchange trading might impose costs on investors in the form of higher trading costs than they would otherwise realize. These effects may differ across asset classes. In the case of non-FINRA member broker-dealers trading U.S. Treasury securities, costs to join an Association include the costs of establishing TRACE reporting. Depending on the firm's activity level in that market, firms might be more likely to withdraw from that market if their anticipated profit levels from U.S. Treasury securities trading do not justify the additional reporting requirements. The impact on liquidity in U.S. Treasury securities markets is not likely to significantly impact investor costs to trade these securities because U.S. Treasury securities are generally very liquid and competition to provide this liquidity is robust. If some non-FINRA member broker-dealers stop competing in the market to provide this liquidity, other broker-dealers are likely to increase their activity in this market, but the Commission acknowledges that if competition to provide liquidity decreases, investor costs to trade U.S. Treasury securities could increase.

Several commenters expressed liquidity concerns with regard to options markets.[315] One commenter stated that FINRA membership costs

[308] Direct capital formation is the assignment of financial resources to meet the funding requirements of a profitable capital project, is in this case, the provision of liquidity to financial markets.

[309] Non-FINRA member firms may also reduce their off-exchange trading outside of ATSs, such as on single-dealer platforms, as part of an effort to avoid being required to join FINRA. However, non-FINRA member firms currently can only take (not make) liquidity on these platforms. It is possible that additional off-exchange liquidity may be available outside of ATSs for other market participants as a result of the amendments to Rule 15b9–1 due to a reduction in non-FINRA member firm trading on single-dealer platforms.

[310] Industry white papers sometimes discuss the concept of natural counterparties for institutional trades. These papers may explicitly or implicitly identify proprietary automated trading firms as sources of information leakage in dark pools. The Commission understands that some ATSs segment orders so that institutional investors do not trade with PTFs. *See, e.g.,* Hitesh Mittal, *Are You Playing in a Toxic Dark Pool? A Guide to Preventing Information Leakage,* J. Trading, Summer 2008, at 20 (ITG white paper), *available at https://jot.pm-research.com/content/3/3/20.* Other industry participants describe a more benign role for automated trading firms as liquidity providers in ATSs. *See* Terry Flanagan, *High-Speed Traders Go Dark,* Markets Media Commentary (2012), *available at https://www.marketsmedia.com/high-speed-traders-go-dark/.*

[311] There is some evidence that some proprietary trading firms are net takers rather than net suppliers of liquidity in equity markets, although the evidence is not conclusive. Using Nasdaq data from 2008–2010, Carrion estimates that these firms supply liquidity to 41.2% of trading dollar volume and take liquidity in 42.2% of trading dollar volume. *See* Allen Carrion, *Very fast money: High-frequency trading on the NASDAQ,* 16 J. Fin. Mkts. 680 (2013). Another study finds that electronic trading firms act as net liquidity suppliers during periods of extreme price movements. *See* Jonathan Brogaard, Allen Carrion, Thibaut Moyaert, Ryan Riordan, Andriy Shkilko & Konstantin Sokolov, *High Frequency Trading and Extreme Price Movements,* 128 J. Fin. Econ. 253 (2018).

[312] Several commenters expressed concerns that the amendments would negatively impact market liquidity in this respect. *See* Cboe Letter at 7; PEAK6 Letter at 4; ABCV Letter at 3.

[313] Firms with very low ATS activity are unlikely to directly connect to an ATS, instead accessing ATSs through a FINRA-member firm. For firms with very limited off-member-exchange activity, ceasing off-member-exchange activity is likely to be less costly than joining an Association. The costs of joining FINRA are discussed in detail in *infra* section V.C.2; for firms with very limited off-member-exchange activity, it is unlikely that the profits generated from this activity would offset FINRA membership costs. However, for firms that generate profits from off-member-exchange activities that exceed FINRA membership costs, it may be less costly to join FINRA than to cease their off-member-exchange activity.

[314] After the 2015 Proposal and again following the 2022 Re-proposal, FINRA evaluated the structure of the TAF to assure that it appropriately considered the business model of certain non-FINRA member firms that might have joined FINRA as a result of the proposed amendments. FINRA has proposed an amendment that would exempt from the TAF transactions executed by proprietary trading firms on an exchange of which the firm is a member. *See* TAF Amendment, *supra* note 146. The Commission's analysis of TAF is based on the proposed TAF structure as outlined in the FINRA By-Laws, Schedule A. TAF and section 3 fees are discussed further in section V.C.2.b, *infra.* Firms would also face additional fixed costs both to establish and maintain Association membership; those costs are discussed in section V.C.2, *infra.*

[315] *See, e.g.,* MMI Letter at 1; ABCV Letter at 3; PEAK6 Letter at 5.

might have ''the potential for impaired liquidity, especially during times of market stress.'' [316] Another commenter indicated that the FINRA TAF fee structure is disproportionally burdensome for proprietary trading firms and risks stifling liquidity in options markets.[317] The commenter also stated that there are fewer incentives to provide the same liquidity under FINRA's proposed fee structure as there are under Cboe's regulatory fee structure.[318] The Commission, however, believes that options market liquidity provision will not be impaired even if these amendments cause options market makers to exit. The Commission observes that bid-ask spreads have remained consistent since 2015 even though, over that same period of time, options market makers have entered and exited the market through varying market conditions.[319]

Changes in business models for non-FINRA member firms may affect market quality on exchanges as well. In addition to trading extensively in the off-exchange market, many non-FINRA member firms are among the most active participants on exchanges. Business model changes by these firms in response to the amendments might lead to less exchange liquidity for several reasons. First, non-FINRA member firms that choose not to join an Association will no longer be able to rely on the rule and trade indirectly on exchanges of which they are not members, unless they comply with the routing or stock-options order exemptions.[320] Second, non-FINRA member firms that do not join an Association will no longer be able to access off-member-exchange liquidity to unwind positions acquired on exchanges, which might reduce their willingness to provide liquidity on exchanges.[321] Third, non-FINRA member firms that choose to join an Association might be subject to additional variable costs (primarily regulatory fees) on their exchange-based trading as well as on their off-member-exchange trading.[322] These firms might respond by trading less actively on exchanges. Finally, non-FINRA member firms might choose to cease trading rather than join an Association or change their business models. Reduced liquidity upon exchanges can result in higher spreads and increased volatility. Increased spreads on exchanges can lead to increased costs for off-exchange investors as well as investors transacting on exchanges, because most off-exchange transactions (including many retail executions) are derivatively priced with reference to prevailing exchange prices. Overall, however, the Commission believes that the amendments will most likely not result in a disturbance of liquidity provision due to the robust competitive conditions of the current market landscape.

2. Effect on Competition To Provide Liquidity

The amendments might impact competition to provide liquidity by increasing the regulatory cost for current non-FINRA member firms. Non-FINRA member firms do not bear the costs associated with FINRA membership. As such, FINRA member firms bear a number of costs not borne by non-FINRA member firms including a number of regulatory fees and indirect costs that are assessed or imposed upon member firms.[323] These costs are a part of equity, options, and fixed income markets and include direct costs such as trading fees that are either assigned only to member firms, such as TAF, or in the case of section 3 fees, member firms may be assigned costs that could be assigned to non-FINRA member firms' off-exchange securities sales. There are indirect costs of disparate regulatory regimes as well.[324] Under the amendments current non-FINRA members that choose to join FINRA will become subject to the regulatory costs associated with FINRA membership, including TAF, GIA and section 3 fees. These changes to regulatory costs for non-FINRA member firms might change competitive forces in the market for providing liquidity as the current non-FINRA member broker-dealers have lower regulatory costs, which might make it less costly for non-FINRA member broker-dealers to provide liquidity.[325] To the extent that non-FINRA member firms do have lower costs for providing liquidity than FINRA member firms, the amendments might eliminate such an advantage, and lead to a reduction in liquidity provided by current non-FINRA member firms.

However, to the extent that these negative effects on liquidity occur, the Commission believes they will be minor in light of several factors. First, while non-FINRA members have been able to avoid direct costs associated with Association membership, in reality, they may have already been bearing a portion of these costs, as FINRA member firms may pass through their fees to non-FINRA member counterparties. In addition, following the implementation of the amendments, current FINRA members will be operating on a more level regulatory cost playing field, which may expand their own provision of liquidity and perhaps balance out any reduction in liquidity from current non-FINRA members. Finally, the provision of liquidity appears to be somewhat resilient to changing market conditions, and more specifically, appears to have been unaffected by the exit of numerous non-member firms since the 2015 Proposal, as discussed below.

Several commenters expressed concern about decreased competition among options market makers.[326] One commenter specifically noted that ''[s]maller options market makers may not have the economies of scale to

[316] *See* ABCV Letter at 3.

[317] *See* PEAK6 Letter at 5. According to the commenter, FINRA fees are partially based on the number of transactions in order to provide protection that is proportional to the number of customer orders of a broker-dealer. This is theoretically at odds with the business model of proprietary traders, which do not have customers. For this reason, the commenter asserts that FINRA fees are ''imbalanced,'' *i.e.,* disproportionately costly to proprietary trading firms relative to the benefits provided by FINRA oversight of these firms.

[318] *Id.*

[319] *See infra* note 330 and discussion in *infra* section V.B.2.

[320] Currently, a non-FINRA member firm can indirectly access an exchange of which it is not a member through a firm that is an exchange member. In light of the elimination of the exclusion for proprietary trading, this activity would not be consistent with the amendments, unless the activity complies with the routing or stock-option order exemptions. *See supra* sections III.B.1 and III.B.2.

[321] These firms could unwind positions on exchanges of which they are a member, but the cost to do so may be higher than if all liquidity sources, including off-exchange liquidity, were available.

[322] It is possible non-FINRA member firms that choose to join an Association may avoid some additional costs by registering as market makers on additional venues, mitigating these charges. Furthermore, they may see a reduction in fees that were formerly paid to their DEA if FINRA assumes that role.

[323] Exchange membership also imposes costs on broker-dealers. Some non-FINRA member firms are members of many exchanges, but not FINRA, while some FINRA-member firms are members of many exchanges as well as FINRA. To the extent that a broker-dealer can avoid FINRA membership, its fee burden might be lower than a broker-dealer that cannot or does not avoid FINRA membership. The Commission believes that many non-FINRA member firms would retain their exchange membership when the amendments are adopted in order to maintain the benefits of being a member of the exchange. Therefore, the Commission only considers the additional cost to the firms that are specific to joining FINRA. The exchange SRO fees are not considered as they are not expected to change. However, a firm may decide to drop its membership on exchanges where it no longer wishes to trade after joining FINRA, because maintaining exchange memberships is costly and firms are unlikely to maintain membership on exchanges where they do not plan to have activity. *See infra* section V.C.2, for more information on the fees associated with FINRA membership.

[324] *See* section V.C.2.f, *infra.*

[325] *See* section V.B.1, *supra* for discussion of competitive effects and investor costs.

[326] *See* ABCV Letter at 3–4; Cboe Letter at 7; Group One Letter at 3; Nasdaq Letter at 3.

adequately absorb [FINRA registration] costs, which could lead to consolidation and decreased competition.'' [327] On the other hand, another commenter suggested that the amendments might increase competition and that they ''will safeguard against certain market participants, in this case high frequency trading firms, from retaining a competitive advantage in the market due to outdated regulations.'' [328]

Despite a recent decline in the number of non-FINRA member options liquidity providers, the Commission does not believe that the amendments will negatively impact options market liquidity provision. Since the 2015 Proposal, the number of non-FINRA member firms has declined from 125 to 64. One commenter pointed out that while some non-members may have since become FINRA members or have been acquired by other market makers, most of the decline in option market making non-members are firms that have ceased trading securities.[329] However, despite this decline in the number of firms, options market liquidity has remained robust. One academic study shows that options bid-ask spreads have remained flat since 2015.[330] NYSE Data Insights similarly suggests that options quoted spreads have remained flat or slightly declined in recent years as overall option trading volumes have continued to hit record highs.[331] While a decrease in the number of competitors can lead to a decline in competition, these data do not appear to suggest that options market liquidity conditions have weakened with the increased industry consolidation.

The Commission does not believe that the costs imposed by these amendments will be large enough to undermine options market liquidity provision or the overall degree of competition in the market. The Commission cannot rule out the possibility, however, that the addition of FINRA costs will serve as catalyst for one or more small non-member options market makers to exit the market,[332] although FINRA's exemption of TAF fees for non-member firms,[333] which several commenters supported, should reduce the likelihood that firms will choose to exit in response to the rule. To the extent that options market makers exit, competition to provide liquidity in options markets may be adversely impacted.

The impact on equity liquidity due to non-FINRA members joining FINRA in response to the amendments is uncertain. The existing differential regulatory cost burdens of FINRA member firms and non-FINRA member firms may have consequences with respect to market quality both for exchange-based and off-exchange trading. For example, because non-FINRA member firms, all else equal, currently face lower variable costs of trading compared to member firms, non-FINRA member firms may be able to provide liquidity at a lower cost than member firms. It may also reduce direct execution costs (such as quoted and effective spreads) for both exchange and off-exchange trades, the latter of which are normally derivatively priced with reference to prevailing exchange quotes. The differential regulatory burden, however, may also reduce depth at best prices because a member firm may not be able to trade profitably at a price established by a non-FINRA member firm that faces lower regulatory costs. Lower liquidity at best exchange prices implies greater price effect of trades, which may increase trading costs, particularly for large orders. For example, if the best price on an exchange is associated with 100 shares of depth, a 200 share order will exhaust depth at the best price and the second 100 share lot may execute at an inferior price.[334] If depth at the best price tends to be larger, it is less likely that an order will exceed the depth available at the best price. The change in the best price associated with an execution that exhausts the depth available at the best price is the price effect of the trade upon the exchange.

3. Competitive Effects on Off-Exchange Market Regulation

Currently, FINRA is the only Association.[335] It is possible, however, for new Associations to enter the regulatory oversight market and compete with FINRA. The amendments to Rule 15b9–1 might create incentives for a new Association (or Associations) to form. The large non-FINRA member firms have commonalities in business models; for example, they typically do not carry customer accounts. They might consider forming a new Association together, which would allow the member of the new Association to be subject to rules and regulations that better fit their business practices. This might allow the new Association to more efficiently provide oversight for current non-FINRA member firms. For example, because these firms collectively conduct a significant portion of off-exchange volume, the creation of a new Association tailored to these firms may be economically viable.

To be registered as a new Association, in addition to requirements that parallel the requirements to be a national securities exchange, a new Association must ''[b]y reason of the number and geographical distribution of its members and the scope of their transactions'' be able to carry out the purposes of section 15A.[336] Any new Association would have to be approved by the Commission. Additionally, a new Association must permit any registered broker or dealer that meets a new Association's qualification standards to become a member.[337] It also must have rules regarding the form and content of quotations relating to securities sold otherwise than on a national securities exchange that are designed to produce fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations.[338] A new Association must also be so organized and have the capacity to enforce compliance by its members and persons associated with its members with, among other things, its own rules and the Exchange Act and the rules and regulations thereunder.[339]

The ability to form an Association is characterized by barriers to entry. The amendments include a 365-day implementation period, which might provide a significant time constraint to form a new Association. A new

[327] *See* Cboe Letter at 7.

[328] *See* Better Markets Letter at 8.

[329] *See* STA Letter at 3–4.

[330] *See* Figure 1 of Jefferson Duarte, et al., Very Noisy Option Prices and Inferences Regarding the Volatility Premium, J. Fin., Forthcoming.

[331] *See* NYSE Data Insights, 2021 Options Year in Review, *available at https://www.nyse.com/data-insights/2021-options-year-in-review.*

[332] These broker-dealers could also choose to remain exempt by joining any remaining exchanges on which they currently trade but are not members. Additionally, they could remain exempt by retaining their current exchange memberships and only discontinue trading on the exchanges for which they currently do not carry membership.

[333] The TAF exemption will be for trading on exchanges at which the proprietary firm is a member. *See supra* note 162 and accompanying text.

[334] This assumes no hidden depth at the best price. If non-displayed depth is present at the best price, the remaining 100 shares will be filled at the best price if at least 100 shares of hidden depth exist at the best price.

[335] *See supra* note 9 and accompanying text.

[336] *See* 15 U.S.C. 78*o*–3.

[337] *See* 15 U.S.C. 78*o*–3(b)(3). Section 15A of the Exchange Act specifically states that an Association shall not be registered as a national securities association unless the Commission determines, among other things, that ''the rules of the association provide that any registered broker or dealer may become a member of such association and any person may become associated with a member thereof.''

[338] *See* 15 U.S.C. 78*o*–3(b)(11).

[339] *See* 15 U.S.C. 78*o*–3(b)(2).

Association would likely incur significant fixed costs to create the infrastructure needed to perform the surveillance and oversight requirements imposed on Associations by statute and regulation. It might also incur substantial costs, including personnel, training, travel, and other costs to provide for effective surveillance and supervision of the off-exchange equity, cross-exchange options, and U.S. Treasury securities markets. Indeed, the only existing Association, FINRA, has resources that enable it to surveil and oversee the off-exchange market.[340] Additionally, while some costs may be lower because CAT already collects information and makes it available to query, a new Association would still have to build its own infrastructure, surveillance logics, and analytical tools, which may create a substantial cost for a new Association.[341]

The existence of multiple Associations might provide benefits to the market as a whole. If a new Association could provide high quality services to members with a lower fee structure, all Associations will have incentives to reduce fees to attract members. This might result in cost savings to brokers and dealers. Second, a new Association might innovate to develop different surveillance and supervision methods that could be more efficient than FINRA's methods.

Competition among Associations might also entail substantial costs. If the market for Associations is characterized by economies of scale, aggregate costs for the same level of regulation might be higher in a market with two Associations than in a market with a single Association. These additional costs would ultimately be borne by the broker and dealer members of either Association, and could be passed on to investors. Second, Associations might compete on the basis of providing ''light touch'' regulation, in essence surveilling less and providing less supervision. As a result, the quality of market supervision might decrease, although the Commission does itself oversee self-regulatory organizations, such as Associations, and accordingly, would not permit a ''race to the bottom.'' [342] Furthermore, some of the benefits of the amendments will be diminished if current non-FINRA member firms created a new Association as opposed to joining FINRA. For example, the new Association will not have the experience or expertise of FINRA in overseeing off-member-exchange market activity. Additionally, the members of a new Association will not be required to report their U.S. Treasury securities market trading activity to TRACE if they are not FINRA members.

The amendments may increase barriers to entry and thus affect the potential for competition among regulators of off-exchange markets. Currently, the primary barrier to entry is the high fixed cost involved in forming and operating an Association. The amendments bring nearly all off-exchange trading under the jurisdiction of an Association, including the trading of firms that currently are not members of an Association (non-FINRA member firms). If these firms join the only existing Association, FINRA, any newly formed Association might have increased difficulty attracting the members needed to support the high fixed costs associated with forming an Association because every broker or dealer that participates in the off-exchange market would already be a FINRA member. This increased difficulty results because many firms may be reluctant to change Associations, either because of the costs to change compliance infrastructures or uncertainty in the regulatory environment of the new Association. Thus, if the amendments result in more firms becoming members of FINRA, a new Association might face increased difficulties attracting members in the future. If the new Association is introduced after implementation of the rule, these stated effects might become more likely as the current non-FINRA member firms would have already joined FINRA. If a competing Association limited the scope of its members or operations, it might not have to duplicate all of the surveillance and supervision functions required to be provided by an Association that does not have those limits. This might lower the costs of forming an Association and alter the barriers to entry.[343]

C. Consideration of Costs and Benefits

This section discusses costs and benefits of the amendments. While the Commission has attempted, where possible, to provide estimated quantifiable ranges, both costs and benefits are difficult to quantify for the amendments for a number of reasons.

The overall benefits of the amendments relate to more stable and uniform surveillance of off-member-exchange activity by the direct, membership-based Association oversight to oversee such activity. As such, the benefits the Commission anticipates from the amendments are largely qualitative and by their nature difficult to measure quantitatively.

The amendments will induce initial, ongoing, and indirect costs which would be similarly difficult to measure for a variety of reasons. First, market participants are heterogeneous in their type, existing exchange memberships, and activity level in the off-member-exchange market. Consequently, compliance costs will vary across firms in a number of dimensions. Second, estimating costs is complicated by the fact that non-FINRA member firms can comply with the proposal in a number of ways, and presumably each will choose to seek compliance in the manner that minimizes the sum of its direct costs (related to joining and maintaining memberships in additional SROs) and indirect costs (which include forgone opportunities to trade profitably and costs associated with revising business strategies). Furthermore, some firms are likely to remain exempt but the Commission lacks data to identify those firms with certainty.[344] At the other end of the spectrum, the minority of non-FINRA member firms that are large and contribute significantly to both member exchange and off-member-exchange trading are unlikely to remain exempt.[345] For the 64 non-FINRA member firms, the Commission believes that most will lose their exempt status, and, while most firms will likely join FINRA, some firms may seek other ways to comply with the amendments (*e.g.,* remaining exempt by expanding their exchange memberships to cover all of the exchanges on which they currently trade or reducing their trading activity to the exchanges on which they currently trade).[346]

[340] *See supra* note 9.

[341] *See* CAT NMS Plan Approval Order, *supra* note 15, 81 FR 84836–39, for a discussion on the benefits provided by CAT with regard to surveillance by SROs.

[342] *See* sections 19(g) and (h) of the Exchange Act, 15 U.S.C. 78s(g) and (h).

[343] Some limitations on Association membership or operations would require exemptive relief for the Association to register with the Commission.

[344] Non-FINRA member firms that provide liquidity on multiple exchanges and trade heavily off-member-exchange are unlikely to be small in terms of net capital and are not low trading volume firms by definition. However, as discussed in *supra* section V.A.1, many non-FINRA member firms are members of a single exchange. Such firms are more likely to have limited exposure to off-member-exchange markets. Such firms will either be exempt from the rule by virtue of having no off-exchange trading or no trading on exchanges of which they are not members or be able to rely on the stock-option order exemption to continue their limited off-member-exchange trading related to their exchange-based brokerage activities.

[345] The diversity of non-FINRA member firms is discussed in *supra* section V.A.1.

[346] *See supra* section V.B.1., which discusses how firms might change their business models in response to the rule.

1. Benefits

As discussed above,[347] some of the firms relying on the Rule 15b9–1 exemption are significant participants in both on and off-member-exchange markets.[348] For example, in September of 2022, $440 billion in listed equities was traded off-exchange by non-FINRA member firms, and $311 billion in listed equities was traded on an exchange to which the firm did not belong.[349] Thus, a substantial amount of off-exchange volume is conducted outside of the regulatory jurisdiction of FINRA, which under the Exchange Act has primary responsibility for overseeing off-exchange activity. Although FINRA has the ability to surveil 100% of cross-market and off-exchange equity trading activity via CAT, it does not have jurisdiction for firms that are not FINRA members. Association membership will supplement the existing oversight of the exchanges, to the extent a firm remains an exchange member, and provide consistent and ongoing application of rules, which vary between exchanges. Regarding off-member-exchange trading, under the current regulatory structure using RSAs, FINRA applies the rules of the different exchanges and the exchanges' interpretations of those rules to such trading. This can result in different interpretations and FINRA registration would promote consistent interpretations and efficiencies in enforcement and regulation with respect to this growing part of the market.[350] As discussed above,[351] the Commission believes the inclusion of more non-FINRA member firms in an Association [352] will improve such Association's ability to supervise off-member-exchange trading activity, particularly in U.S. Treasury securities markets. This would enhance FINRA's ability and—through the information FINRA shares with the Commission—the Commission's ability to effectively oversee regulation of trading on equity, fixed income, and option markets.

Some commenters expressed concern that there are no clear benefits resulting from the amendments because they believe that exchange SROs provide sufficient regulatory functions.[353] The Commission, however, believes that the amendments to Rule 15b9–1 would improve supervision of non-FINRA member firms by leveraging FINRA's experience and investigative tools, particularly those targeted at off-member-exchange markets. FINRA, currently the only Association, has considerable experience and expertise from overseeing a large number of brokers and dealers that trade off-exchange or across exchanges. This makes FINRA's potential regulation of non-FINRA member firms with off-exchange or cross-market trading activity particularly efficient. FINRA stated that ''[d]irect FINRA jurisdiction would yield a number of benefits including ensuring that PTFs are subject to FINRA rules and providing for more consistent regulatory treatment across entities engaging in similar trading activity, which would result in more thorough oversight and stronger cross-market and cross-product surveillance.'' [354]

In addition, the amendments, as adopted, would enhance the supervision and enforcement for equities and options beyond the benefits from the CAT NMS Plan.[355] While CAT improves data accessibility for all SROs, it does not address FINRA's lack of jurisdiction over non-FINRA member firms with off-member-exchange trading activity. Several commenters believed that reporting of non-FINRA member identifying information and activity pursuant to the CAT NMS Plan would eliminate the need for firms to join FINRA and would provide FINRA a near complete picture of off-member-exchange trading activity.[356] However, FINRA stated that even with non-FINRA member firm trading activity information, ''FINRA does not have the independent ability to examine for, investigate, or enforce potential violations of the federal securities laws or FINRA rules with respect to non-member firms it identifies through surveillance or other means.'' [357] The Commission agrees that, although FINRA now has additional information with respect to non-FINRA member firm activity, it still lacks jurisdiction over non-FINRA member firms, and the amendments would provide such jurisdiction, thereby leading to expanded supervision and enforcement of existing FINRA rules and regulations.[358] In particular, off-member-exchange trading by current non-FINRA members will receive more efficient oversight following implementation of the amendments.[359]

Some commenters stated that Association membership should not be mandated for options market makers because FINRA regulation is focused on protecting customers and options market makers do not carry customer accounts.[360] However, non-FINRA member firms play a significant role in the execution of retail customer orders routed to them by introducing broker-dealers. Commission data indicate that two of the three largest options consolidators, which handled approximately 43% of wholesaled retail customer options orders in 2022, are presently not FINRA members.[361] Further, FINRA stated that ''for certain products and exchanges, some non-member firm conduct may not fully be subject to exchange rules that provide for important protections in connection with the execution of customer orders (*e.g.,* not all exchanges have comparable best execution rules).'' [362]

Commenters also stated that FINRA membership was unwarranted for options market makers since off-member-exchange trading represents only a very small share of the overall trading activity of these firms.[363] However, Commission analysis reveals that the overall level of off-member-exchange options activity by non-FINRA member firms involves non-trivial trading volume, exceeding $130 million per day, and therefore warrants Association oversight or exemption via mandated membership on all exchanges on which the broker-dealer trades.[364] In addition, options market makers

[347] *See supra* section I.

[348] *See supra* section V.A.1.

[349] *See supra* Table 1.

[350] Exchange SRO rules would continue to apply to broker-dealer firms that are exchange members and become FINRA members as a result of the amendments to Rule 15b9–1. The Commission believes that Rule 17d–1 DEA designations and Rule 17d–2 plans will likely be utilized in areas of overlapping rules to mitigate duplicative application of exchange SRO and FINRA oversight, in the same fashion as they already are utilized for the many broker-dealer firms that are exchange members and FINRA members.

[351] *See supra* section I.

[352] This discussion presumes that the most likely response by non-members to the amendments will be to join FINRA, rather than choosing another option, such as remaining exempt from Association membership by joining every exchange on which the broker-dealer trades, ceasing trading operations, or forming a new Association.

[353] *See, e.g.,* ABCV Letter at 2; Cboe Letter at 7; FIA PTG Letter at 2; Group One Letter at 1; MMI Letter at 3; Nasdaq Letter at 4.

[354] *See* FINRA Letter at 7.

[355] *See* CAT NMS Approval Order, *supra* note 341.

[356] *See, e.g.,* Cboe Letter at 2; ABCV Letter at 3; CTC Letter at 3; Group One Letter at 1; PEAK6 Letter at 2; STA Letter at 2.

[357] *See* FINRA Letter at 6. FINRA also stated that it identified non-member firms as potential respondents in five percent of its market regulation investigations conducted in 2020 and 2021.

[358] *See supra* section III.A.

[359] Currently, oversight of off-member exchange trading is coordinated through RSAs, which are subject to certain limitations. *See supra* note 294.

[360] *See, e.g.,* ABCV Letter at 2; PEAK6 Letter at 2; Group One Letter at 1–2; STA Letter at 3–4.

[361] Based on 2022 filings under 17 CFR 242.606 (''Rule 606'').

[362] *See* FINRA Letter at 7–8.

[363] *See* Nasdaq Letter at 3; PEAK6 Letter at 2.

[364] *See supra* note 269.

comprise the majority of the twelve non-FINRA firms among which off-exchange equity volume is concentrated. Therefore, mandating Association membership for non-FINRA member options market makers will also result in enhanced oversight of the off-exchange equity trading of these firms, which is currently covered by RSAs.

Some commenters stated that off-member-exchange activity was frequently carried out for general hedging purposes, which, they stated, is trading activity that does not justify mandatory FINRA oversight and its associated costs,[365] especially if this activity serves to facilitate options market making.[366] While the Commission is cognizant of the critical role played by market makers, it nevertheless believes that such trading activity is not immune to violative behavior and therefore does not justify exemption from the amendments.[367]

The benefits of the adopted amendments will be pronounced in the U.S. Treasury securities markets. A significant amount of volume in U.S. Treasury securities markets comes from broker-dealers that are likely to be required to become FINRA members as a result of the amendments.[368] If these broker-dealers become FINRA members, they will be required to comply with FINRA rules, including TRACE reporting requirements. This will have a positive impact on market quality by increasing coverage of data reported to TRACE for trades not occurring on a covered ATS.[369] The amendments will also provide additional market oversight by bringing non-FINRA member trading in the Treasury markets under FINRA jurisdiction.[370] Non-FINRA member firms do not report to TRACE, and they are only specifically identified by MPID in TRACE when their U.S. Treasury securities trades occur on a covered ATS; they are not identified by MPID for other trades of U.S. Treasury securities that do not occur on covered ATSs, such as direct dealer-to-dealer transactions.[371] Thus, the amendments will improve the quality and complete the coverage of TRACE data to include all non-FINRA member firm transactions and increase regulatory transparency into the U.S. Treasury securities markets.[372] One commenter suggested that current TRACE reporting captures effectively all non-FINRA member U.S. Treasury securities transactions and that no present gap in U.S. Treasury securities transaction reporting exists.[373] The Commission believes that, while the majority of U.S. Treasury securities transactions are already reported to TRACE,[374] there are coverage gaps—even as the Commission cannot estimate the actual amount of U.S. Treasury securities trading activity not currently reported to TRACE.[375]

The Commission believes that the amendments could provide more substantial benefits to the market for other TRACE-reported (*e.g.,* non-U.S. Treasury securities fixed income) securities, since transactions by non-FINRA members in these securities are completely hidden from FINRA oversight.[376] Moreover, unlike U.S. Treasury securities, transactions data on several non-U.S. Treasury TRACE-reported securities, including corporate bonds and agency debt securities, are disseminated immediately to the public.[377] This immediate dissemination has allowed non-FINRA member firms to observe other firms' anonymized trades in non-U.S. Treasury fixed income securities[378] without facing the burden of reporting their own trades, potentially providing non-FINRA members a competitive advantage, the cost of which is borne by the investing public through reduced price discovery. Therefore, an increase in FINRA membership due to the amendments could be particularly beneficial to the transparency of these markets, although the trading volume in these securities by non-FINRA members, and thus the full extent of these benefits, remains uncertain since non-FINRA members do not have to report their trades in these securities.

While current members of an Association would not be directly affected by this rule, they will benefit by having a more level playing field in reporting trades in the U.S. Treasury securities markets. With more uniform regulatory requirements, firms might compete more equitably to supply liquidity both on exchanges and in the off-exchange market.

Two commenters raised concerns about exchanges acting as SROs and potential conflict of interest in regulating effectively versus catering to the exchange's customers.[379] In this scenario, switching from exchange SROs to FINRA serving as DEA should reduce concerns held by these commenters regarding conflict of interest.

Although fewer firms will be able to rely on the narrower exemptions, the narrower exemptions will continue to provide the existing benefits for non-FINRA members as well as other market

[365] *See* Cboe Letter at 3; Nasdaq Letter at 4; CTC Letter at 5; PEAK6 Letter at 4.

[366] *See* Cboe Letter at 3; ABCV Letter at 4, PEAK6 Letter at 4.

[367] One commenter stated that a general hedging exemption would ''increase fraudulent activity in the market by obfuscating risk activities in the options market.'' *See* letter from Cullin Coyle (Oct. 31, 2022).

[368] The Commission estimates that seven such firms accounted for $6 trillion in U.S. Treasury securities volume executed on covered ATSs in 2022 that was reported to TRACE, which was more than 3.67% of the total U.S. Treasury securities volume traded in 2022 that was reported to TRACE, and that five such firms' U.S. Treasury securities volume executed on covered ATSs in Apr. 2023 that was reported to TRACE accounted for approximately 2.65% of total U.S. Treasury securities volume in Apr. 2023 that was reported to TRACE. *See supra* section II.B.

[369] Or trades not involving certain depository institutions, which are mandated to report U.S. Treasury securities trades to TRACE. *See supra* note 123.

[370] FINRA agreed that the benefits of additional U.S. Treasury securities market oversight are likely to be substantial and reported that non-FINRA member broker-dealer firms and non-broker-dealer firms were identified in 17% of the FINRA surveillance alerts generated by its Treasuries manipulation patterns in 2020 and 2021. *See* FINRA Letter at 10; *see also supra* note 119.

[371] FINRA stated that ''non-member firms' activity accounts for a very significant portion of trading in Treasuries securities.'' *See* FINRA Letter at 9.

[372] One commenter stated that the amendments ''will help to enhance transparency in the Treasury markets by increasing the percentage of transactions being reported to the TRACE reporting system.'' *See* Better Markets Letter at 10.

[373] *See* FIA PTG Letter at 3. The commenter also stated that to the extent that any reporting gaps in U.S. Treasuries exist, it would be preferable to implement a more targeted solution requiring non-members to report these transactions via account ownership identifiers rather than mandating FINRA membership. *See* FIA PTG Letter at 3.

[374] *See id.*

[375] *See supra* note 55.

[376] *See supra* section V.A.1. Non-U.S. Treasury fixed income securities that are TRACE-reported include corporate debt, agency debt, and asset backed securities (such as student and auto loans). *See* FINRA, Frequently Asked Questions (FAQ) about the Trade Reporting and Compliance Engine (TRACE), *available at https://www.finra.org/filing-reporting/trace/faq#Reporting.* In May 2023, average daily trading volume reported to TRACE for non-convertible corporate debt was $39.9 billion; agency debt, $3.7 billion; asset back securities, $1.2 billion. *See* FINRA, TRACE Volume Reports—Total Trades, *available at https://www.finra.org/finra-data/browse-catalog/trace-volume-reports/trace-volume-total-trades.* These are predominantly over-the-counter markets. For example, for information about corporate bond trading see Maureen O'Hara and Xing (Alex) Zhou *Corporate Bond Trading: Finding the Customers' Yachts* J. Portfolio Management (2022). For a recent study on fixed income markets, *see* Understanding Fixed Income Markets in 2023 *available at https://www.sifma.org/resources/research/understanding-fixed-income-markets-in-2023/.*

[377] *See supra* note 259 for information on the difference between the dissemination of TRACE for U.S. Treasury securities and TRACE for other TRACE eligible securities. *See also* FINRA, TRACE Reporting Timeframes and Transparency Protocols, *available at https://www.finra.org/filing-reporting/trade-reporting-and-compliance-engine-trace/trace-reporting-timeframes.*

[378] FINRA publishes aggregate TRACE U.S. Treasury security data. *See* About TRACE Treasury Aggregate Statistics, *available at https://www.finra.org/filing-reporting/trace/data/trace-treasury-aggregates/about.*

[379] *See* letters from: Joseph Crowe (Aug. 12, 2022) and Joe Edwards (Aug. 12, 2022).

participants. These exemptions will continue to provide the current cost savings for non-FINRA members as they will continue to not be required to join FINRA and thus avoid the costs of doing so. Additionally, the routing exemption will facilitate regulatory compliance designed to improve market quality.[380] The Commission also believes that the stock-option order exemption will facilitate liquidity in both stock and options markets, which is likely to improve market quality.[381]

2. Costs

The amendments, by narrowing the existing exemption, would result in brokers and dealers that no longer qualify for the exemption having to comply with section 15(b)(8) of the Exchange Act by either limiting their trading to exchanges of which they are members, joining an Association, or abiding by one of the stated exemptions. Under the amendments, therefore, non-FINRA member firms that choose to continue any off-member-exchange activity will be faced with choices that would involve corresponding costs. For example, non-FINRA member firms might incur costs related to membership in an Association or costs necessitated by additional exchange memberships. Additionally, some non-FINRA member firms might incur the costs of losing the benefits of trading in the off-member-exchange market if they decide not to join an Association. There might also be indirect costs associated with the amendments, depending on whether a non-FINRA member chooses to join an Association or not.

Most of the direct costs incurred in joining an Association and maintaining membership therein are dependent on firm characteristics and activity level. Furthermore, some non-FINRA member firms might comply by ceasing their off-member-exchange trading activity, avoiding many of these costs but forgoing the opportunity to trade profitably in some venues. The Commission estimates that, if all 12 of the non-FINRA member firms that had the most significant off-member-exchange trading volume in equities in April 2023 were to join FINRA, the median initial cost[382] of the amendments for these firms would be about $95,000 and the median ongoing annual costs would be about $1.07 million. The Commission estimates that, if all 64 non-FINRA member firms as of April 2023 were to join FINRA, the median initial costs would be about $95,000 and median ongoing annual costs would be about $103,416.[383] Some commenters stated that the costs of FINRA registration are substantial and are likely to have a profound economic impact on small non-FINRA member firms.[384] While the Commission agrees that the costs of FINRA membership are significant, the aggregate costs for the subset of 12 largest non-FINRA member firms represent the majority (approximately 76%) of the aggregate ongoing costs potentially stemming from the amendments, and these large non-member firms are more readily able to bear such costs through economies of scale and greater economic profits. The Commission believes that smaller non-FINRA member firms as well as new entrants will experience much lower costs. In particular, the initial costs for such firms will be close to the lower estimates discussed below, because these costs are largely dependent on the size and complexity of the firms. Additionally, because smaller firms and new entrants have lower trading activity, the ongoing costs will also be significantly lower as ongoing costs are highly impacted by said trading activity. Finally, any non-FINRA member could choose to avoid these costs and remain exempt from Association membership by joining all exchanges on which they trade but do not currently carry membership.

a. Costs of Joining an Association

Based on discussions with FINRA,[385] and industry participants, the direct compliance costs on non-FINRA member firms of joining FINRA are composed of FINRA membership application fees and any legal or consulting costs necessary for effectively completing the application to become a member of FINRA (*e.g.,* ensuring compliance with FINRA rules including drafting policies and procedures as may be required).

The fees associated with a FINRA membership application can vary. As an initial matter, the application fee to join FINRA is tier-based according to the number of registered persons associated with the applicant. This one-time application fee ranges from $7,500 to $55,000.[386] The initial membership fee for FINRA is $7,500 for firms with ten or fewer representatives registered with FINRA, $12,500 for firms with 11 to 100 representatives registered with FINRA, and $20,000 for firms with 101 to 150 representatives registered with FINRA.[387] Based on its knowledge of the size and business models of non-FINRA member firms, the Commission believes that the median application fee would be $12,500 and that most non-FINRA member firms would not incur FINRA application fees exceeding $20,000.[388]

In addition to the application fees and data reporting costs, the Commission has taken into account the cost of legal and other advising necessary for effectively completing the application to be a member of FINRA. Some firms might choose to perform this legal work internally while others may use outside counsel for the initial membership application. In making this choice, non-FINRA member firms will likely take into account factors such as the size and resources of the firm, the complexity of the firm's business model, and whether the firm previously used outside counsel to register with any exchanges or the Commission. Based on conversations with industry participants that assist with FINRA membership, for non-FINRA member firms that choose to employ outside counsel to assist with their FINRA membership application, the cost of such counsel ranges from approximately $40,000 to $125,000, with a midpoint of $82,500. FINRA stated in a comment letter that ''FINRA anticipates being able to process most of these new membership applications pursuant to the expedited process within 60 days after submission of the application.'' [389] Factors affecting the specific costs and anticipated timeframe

[380] *See supra* section III.B.1 for more information on the purpose of the routing exemption.

[381] *See supra* section III.B.2 for more information on the stock-option order exemption.

[382] Initial costs include the FINRA membership application fee and fees associated with employing outside counsel to assist with the application, *See* Table 3, *infra.*

[383] *See* Table 3 and Table 4, *infra,* for a breakdown of these costs. The Commission estimates that the total aggregate initial and ongoing annual cost of the amendments across the 12 largest non-FINRA member firms (all 64 non-FINRA member firms) is approximately $31 million ($45 million), not inclusive of potential TRACE reporting costs set forth in section V.C.2.c, *infra.* Firms with no trading volume in April 2023 are included in these estimates. *See supra* section II.B. They are unlikely to join FINRA because generally firms that do not effect transactions in, or induce or attempt to induce the purchase or sale of, any security other than transactions they effect in securities solely on a national securities exchange of which they are members are not required to join FINRA under section 15(b)(8) of the Act. Therefore, these firms are less likely to incur initial and/or ongoing FINRA membership costs, and by including them in the costs estimates, the Commission likely has overestimated significantly the total initial and ongoing annual costs.

[384] *See, e.g.,* Nasdaq Letter at 4; Cboe Letter at 7.

[385] *See also* FINRA Letter at 5–7.

[386] *See* FINRA By-Laws, Schedule A, section 4.

[387] *Id.*

[388] Based on 2022 FOCUS data, no non-FINRA member firm has more than 150 registered representatives. FINRA stated that ''FINRA believes that most non-member firms would not incur application fees exceeding $12,500.'' *See* FINRA Letter at 12.

[389] *See id.* at 12–13.

of a particular firm include the number of associated persons, the level of complexity or uniqueness of the firm's business plan, and whether the firm has previously completed exchange membership applications with similar requirements.

TABLE 3—MEDIAN FIRM IMPLEMENTATION COSTS [1]

Cost	Median
Application to join FINRA	$12,500
Legal consulting	82,500
Total	95,000

[1] Medians are used where possible. Cost estimates are reported as ranges for legal consulting and compliance work; for these estimates, the midpoint is used.

b. Costs of Maintaining an Association Membership

With respect to ongoing costs, three components of such costs are any ongoing fees associated with FINRA membership, costs of legal work relating to FINRA membership, and costs associated with additional compliance activities. The ongoing membership-related fees associated with FINRA membership include the annual GIA; and the TAF and section 3 fees, among others.[390]

With certain assumptions, the Commission attempted to estimate direct compliance costs that a non-FINRA member firm is likely to face to comply with the amendments. The estimates apply primarily to the 12 non-FINRA member firms that have significant off-member-exchange trading activities in equities; smaller firms will face lower costs compared to these 12 firms because they have less revenue and trading volume that would be subject to GIA, TAF, and section 3 fees. However, non-FINRA member firms may already indirectly bear some of these costs, as they may be passed through by FINRA member counterparties or executing brokers. Ongoing annual cost estimates are broken down in Table 4.

The annual GIA generally requires members to pay a percentage of the member firm's total annual revenue based on a graduated scale.[391] The magnitude of the annual GIA is based on the total annual revenue, excluding commodities income, reported by the member firm on its FOCUS Form Part II or IIA.[392] Based on 2022 FOCUS Form data from the 12 aforementioned non-FINRA member firms, the Commission has determined that the average annual total revenue of non-FINRA member firms is approximately $1.2 billion, with a median of $491 million.[393] FINRA's graduated GIA scale results in a median GIA of $327,870 for the 12 large non-FINRA member firms and a median GIA of $33,655.65 for all 64 non-FINRA member firms as of April 2023.[394]

The magnitude of the TAF depends on the transaction volume of a FINRA member that is covered by the TAF as described in the FINRA By-Laws.[395] The Commission estimates that off-member-exchange equity and options trading by the 12 large non-FINRA member firms would generate a median incurred TAF of around $119,255.85 with an average TAF of $304,994.44.[396] The Commission believes that the TAF for non-FINRA member firms not among the 12 identified large non-FINRA member firms would be far lower because the median non-FINRA member firm has far lower trading volume than the typical firm of the 12 identified in the data.[397] Specifically, the Commission estimates that the median (average) annual TAF for all 64 non-FINRA member firms would be $6,746.92 ($68,433.18).[398]

Some off-member-exchange trading by non-FINRA member firms may no longer be profitable when TAF is incurred. Several commenters expressed concerns that TAF costs would be significant.[399] Consequently, non-FINRA member firms may reduce their trading both on exchanges and off-exchange after joining an Association.[400] In May of 2015, FINRA issued a Regulatory Notice proposing to amend the TAF such that it would not apply to transactions by a proprietary trading firm effected on exchanges of which the firm is a member, to coincide with originally proposed changes to Rule 15b9–1. FINRA re-opened the comment period on its Regulatory Notice in December 2022, after the 2022 Re-Proposal.[401] And in June 2023, FINRA filed its TAF Amendment.[402] FINRA's TAF Amendment will exempt proprietary trading firms when they trade securities on exchanges of which they are a member, which several

[390] There are additional fees associated with maintaining a FINRA membership (*e.g.,* CAT fees). There are also additional continuing education and testing requirements, which will impose costs upon firms joining FINRA. Additionally, there are *de minimis* fees (branch registration fee and system processing fee, among others). *See* FINRA By-Laws, Schedule A. The Commission also believes that non-FINRA member firms would not need to register additional associated persons because the exchange SRO rules are already comprehensive in this regard. *See infra* section V.C.2.d. These additional fees are not quantified since their estimation requires unavailable specialized firm data. Nonetheless, the Commission believes that the fees specified in Table 4 represent the vast majority of ongoing FINRA membership costs.

[391] *See* FINRA By-Laws, Schedule A. For example, FINRA imposes a 2023 GIA as follows: (1) $1,200 on a member firm's annual gross revenue up to $1 million; (2) a charge of 0.1511% on a member firm's annual gross revenue between $1 million and $25 million; (3) a charge of 0.3232% on a member firm's annual gross revenue between $25 million and $50 million; and so on as provided in Schedule A. When a firm's annual gross revenue exceeds $25 million, the maximum of current year's revenue and average of the last three years' revenue is used as the basis for the income assessment.

[392] *See* FINRA By-Laws, Schedule A, section 2. *See also* FOCUS Report Form X–17A–5, Part II and IIA.

[393] Based on 2022 Quarterly Part II/IIA FOCUS data.

[394] ($1,200 for the first $1 million of revenue) + (0.1511% × annual revenue greater than $1 million up to $25 million) + (0.3232% × annual revenue greater than $25 million up to $50 million) + (0.0644% of annual revenue greater than $50 million up top $100 million) + (0.0454% of annual revenue greater than $100 million to $5 billion) + (0.0494% of annual revenue greater than $5 billion up to $25 billion) + (0.1063% of annual revenue greater than $25 billion). Although the average annual total revenue exceeds the median annual total revenue, there are a number of firms that have low GIA, which causes the midpoint of GIA to exceed the average GIA. Non-FINRA member firms vary in size. GIA for the 12 largest firms used in these calculations, is anticipated to be far larger than for the remaining smaller non-FINRA member firms. *See* FINRA By-Laws, Schedule A, section 1(c). The total ongoing annual GIA cost for the 12 largest non-FINRA member firms (all 64 non-FINRA member firms) is approximately $8 million ($11.5 million).

[395] *See* FINRA By-Laws, Schedule A, section 1(b).

[396] Insofar as options trading is concerned, the estimated TAF includes trading activity on an exchange where a firm is not a member. If a firm's equity or options trading activity is on an exchange where it is a member, it does not incur the TAF, and if a firm's activity is on an exchange where it is not a member the activity incurs the TAF unless it is covered by an exemption in FINRA's By-Laws. *See infra* note 403 and accompanying test; *see also* FINRA By-Laws, Schedule A, section (1)(b)(2)(F). The Commission does not have information on what proportion of non-FINRA member firm activity on any exchange where such a firm is not a member would qualify for exemption from the TAF under FINRA By-Laws. To the extent that such activity would qualify for a TAF exemption, the TAF estimates set forth herein may overestimate the actual TAF that firms would incur if they join FINRA. In addition, firms that join FINRA may be able to reduce their TAF cost by joining additional exchanges. Estimates of the TAF are based on the off-member-exchange sell volume reported to CAT for non-FINRA member firms. The estimated TAF is equal to estimated off-exchange equity sell volume × $0.000145 and options contract volume × $0.00244. The $0 minimum is associated with firms that have almost no off-member-exchange volume.

[397] *See supra* section III.A.

[398] The total ongoing annual TAF cost for the 12 largest non-FINRA member firms (all 64 non-FINRA member firms) is approximately $3.7 million ($4.4 million).

[399] *See, e.g.,* CTC Letter at 4; FIA PTG Letter at 4; PEAK6 Letter at 4; STA Letter at 4.

[400] *See supra* section V.B.1 for more information on how firms may change their trading practices in response to the rule.

[401] *See supra* note 161.

[402] *See supra* note 146; *see also supra* note 162 and accompanying text.

commenters supported.[403] This change to the TAF will likely lower the cost for non-FINRA member firms to join an Association.[404]

In addition to the TAF, non-FINRA member firms that choose to join FINRA may incur additional section 3 fees. Using data on off-exchange equities trading during April 2023, the Commission estimated that section 3 fees incurred by the 12 large non-FINRA member firms due to their off-exchange trading would have a median incurred section 3 fee of $564,217.42 annually, with an average incurred section 3 fee of $1,455,114.27.[405] The median (average) section 3 fee for all 64 non-FINRA member firms as of April 2023 is estimated to be $3,013.56 ($303,595.36).[406] Some of these fees may already be paid by non-FINRA member firms that engage the services of a member firm clearing broker. However, FINRA lacks the authority to assess section 3 fees against non-FINRA member firms, in which case FINRA may assess the fee to the member firm counterparty to the transaction. In these cases, the FINRA-member may pass-through a portion of the fee to the non-FINRA member counterparty or executing broker. While these fees would represent a cost to non-FINRA member firms, the cost would be largely offset to the industry as a whole by a reduction of section 3 fees incurred by member firms (or clearing brokers acting on behalf of a member firm) when they buy from a self-clearing, non-FINRA member firm.[407]

Ongoing compliance costs would depend on the business circumstances of each firm and the types of issues that could arise. As in the case of the initial membership, some non-FINRA member firms may choose to conduct ongoing compliance activities in-house while others may seek to outsource this work.[408] Based on discussions with industry participants, the Commission estimated that the ongoing compliance cost for firms that outsource this work would range from $24,000 to $96,000 per year, with a median of $60,000.[409] In the case of some non-FINRA member firms, *i.e.,* those that are affiliates of FINRA members, this cost is likely to be lower as they may be able to leverage compliance work already being performed.

FINRA members may also be required to pay the Personnel Assessment fee.[410] The annual Personnel Assessment fee ranges from $160 to $180 per employee and applies to principals or representatives in the FINRA member's organization. Using FOCUS data, the Commission estimates that the average non-FINRA member firm would incur a Personnel Assessment fee of no more than $2,400, and the median non-FINRA member firm would incur a Personnel Assessment fee of $0.[411] The Commission further estimates that the maximum Personnel Assessment fee incurred by one of these non-FINRA member firms would be $22,250.

The Commission estimates that the median ongoing cost for the identified largest 12 non-FINRA member firms would be $1,071,344 and the median ongoing cost for all 64 non-FINRA member firms would be $103,416. However, as discussed above, these costs could vary. The section 3 fees which make up a large portion of these costs are likely to be overestimated for reasons stated above. However, FINRA members currently pay section 3 fees and TAF when transacting on the buy-side with non-FINRA members. To the extent that these costs are currently passed on to non-FINRA members, both section 3 fees and TAF are likely to be overestimated.[412]

TABLE 4—MEDIAN FIRM ONGOING ANNUAL COSTS [1]

Cost	Median (12 largest non-member firms)	Median (all non-member firms)
Gross Income Assessment	$327,870.00	$33,655.65
Trading Activity Fee	119,255.85	6,746.92
Personnel Assessment	0	0
Section 3 Fee	564,217.42	3,013.56
Compliance Work	60,000	60,000
Total	1,071,344	103,416

[1] Non-FINRA members are recognized as of April 2023. *See supra* note 394 and accompanying text. The TAF cost also represents a transfer from current non-FINRA member firms to current member firms. The TAF is calculated using off-exchange sell volume from CAT. The section 3 fee estimate assumes that the firms currently pay no section 3 fees. It is likely that firms that clear through a member firm are currently assessed these fees indirectly. Median Personnel Assessment Fees are estimated to be zero based on analysis using FOCUS data. *See supra* note 410.

[403] *See, e.g.,* MMI Letter at 3; PEAK6 Letter at 4; STA Letter at 4.

[404] In the 2015 Proposing Release, *supra* note 1, the Commission solicited comment on the effect of the proposed TAF amendments, including the effect should the TAF be assessed to non-FINRA member firms that choose to become FINRA members. With regard to the TAF, one commenter stated that ''[t]he potentially most significant impact from a transaction cost perspective is FINRA's Trading Activity Fee.'' *See* FIA PTG at 4. The Commission believes that proposed changes to TAF fees to exempt on-member-exchange trading activity might reduce the associated fees by as much as 75% (95%) for some firms trading in equity (options) markets. Based on discussions with FINRA, TAF relief could amount to nearly $9 million for some current non-member firms.

[405] Section 3 fees are estimated using non-FINRA member firm off-exchange sell dollar volume calculated in CAT. The section 3 fee obligation is calculated as: Non-FINRA member firm Sell Dollar Volume × $8.00/$1,000,000. The $8.00/$1,000,000 is the FINRA fee rate for Fiscal Year 2023. *See* FINRA By-Laws of the Corporation, Schedule A to the By-Laws of the Corporation, section 3—Regulatory Transaction Fee. *See also* Securities Exchange Act Release No. 96724 (Jan. 23, 2023) and press release, Commission, Fee Rate Advisory #2 for Fiscal Year 2023 (Jan. 23, 2023), *available at https://www.sec.gov/news/press-release/2023-15.*

[406] The total ongoing annual section 3 cost for the 12 largest non-FINRA member firms (all 64 non-FINRA member firms) is approximately $17.5 million ($19.5 million).

[407] Currently, when the sell side of an off-exchange transaction is a non-FINRA member firm, FINRA may assess the section 3 fees on the buy side counterparty. *See* the discussion of section 3 fees in section V.A.2, *supra,* for more information.

[408] Ongoing compliance activities may include core accounting functions, updating policies and procedures, and updating forms filed with regulators.

[409] For firms that choose to do this work in-house, the Commission estimates that the costs of ongoing compliance may be less than $96,000. This figure assumes non-FINRA member firms may have experience in ongoing compliance work with SROs through their exchange membership(s) and therefore only captures the incremental cost of compliance with Association rules.

[410] *See* FINRA By-Laws, Schedule A, section 1(e).

[411] Based on 2022 FOCUS data, the number of registered representatives of non-FINRA member firms that connect directly to ATSs ranges from 0–163, with an average of 29 and a median of 0.

[412] Furthermore, to the extent that section 3 fees and TAF are not currently being passed on to non-members, the implementation of the amendments will result in a reduction of such fees for current members transacting on the buy-side that have been paying these fees in lieu of their non-member counterparties.

In addition to the cost estimates discussed above, the Commission recognizes that both non-FINRA member firms and SROs would incur other direct and indirect costs because of the increased regulatory requirements of the amendments. Specifically, there would be compliance costs associated with regulation by FINRA. However, non-FINRA member firms that choose to join an Association may have FINRA assigned as their DEA. Such an assignment could eliminate separate DEA fees that the non-FINRA member firms may pay to their current DEA. Alternatively, one commenter stated that if FINRA is not assigned as their DEA, then existing DEA fees paid to an SRO might be duplicative upon joining an Association.[413] The Commission acknowledges the possibility of duplicate DEA fees in these circumstances but believes that Rule 17d–1 could be utilized by FINRA and the exchange SROs to mitigate duplicative DEA financial responsibility oversight over their common members and Rule 17d–2 plans could similarly be utilized to mitigate the potential for duplicative SRO oversight over their common members in areas other than financial responsibility.[414]

To the extent that they do not already do so, firms would face additional costs related to coming into compliance with Association rules. Additional costs would include actions that are required to accommodate normal supervision and examination by an Association. The Commission was not able to estimate these costs, although the costs would vary among non-FINRA member firms.

Several commenters submitted estimates for the cost of becoming FINRA members.[415] In addition, many commenters stated that FINRA fees would be substantial and constitute a considerable sum, believing that FINRA fees would be unduly burdensome and outweigh perceived benefits.[416] Several commenters believed in particular that FINRA membership would be costly to proprietary trading firms with no customer business.[417] One commenter stated that the Commission did not consider other costs associated with FINRA membership, including opportunity costs associated with FINRA examinations.[418] The Commission evaluated the most significant costs of FINRA membership but acknowledges that being subject to regular examination by FINRA is an additional cost of FINRA membership. One commenter noted that additional regulatory costs associated with FINRA membership would be manageable compared to the cost of the TAF.[419] As stated above, given that FINRA has amended the TAF, the ongoing costs could be lower than prior estimates. However, FINRA fees must be filed with the Commission and such fees must be consistent with the Exchange Act.

c. Costs of TRACE Reporting for Non-FINRA Member Firms That Trade U.S. Treasury Securities

Additionally, to the extent that a firm trades fixed income securities, they will also have implementation and ongoing costs associated with TRACE reporting. The Commission believes that seven non-FINRA member firms have had significant trading activities in U.S. Treasury securities markets and, since they do not presently incur the costs of reporting U.S. Treasury (or non-U.S. Treasury) securities to TRACE, may currently have a competitive cost advantage over FINRA member broker-dealers. The Commission estimates that these non-member firms will each have an initial cost of $2,025, associated with setting up systems for TRACE reporting. This cost includes the Direct Circuit Connectivity Fee for TRACE reporting through Nasdaq, in which Nasdaq facilitates the reporting to TRACE. FINRA does not charge a Transaction Reporting Fee for trading activity in U.S. Treasury securities markets.[420] The Commission estimates an aggregate ongoing cost for each firm of $125,100. There are three ways for firms to connect into TRACE. First, firms may directly report with the FIX protocol through Nasdaq, who is the vendor. Second, firms may use a third-party service bureau with FIX protocols to submit to TRACE. The costs of reporting via FIX protocols are outlined in Table 5. The Commission estimates the cost of third-party reporting to TRACE to be approximately $2,000 per month.[421] Finally, firms with lower reporting requirements have the option of reporting using the Secure Web Interface known as FINRA TRAQS for a fee of $20 per month, which would allow these firms to avoid port fees and connection fees to Nasdaq's FIX reporting system. Additionally, costs for these firms might be significantly lower for firms with low volume, as the reporting cost is based on the volume. To the extent that non-FINRA member firms trade in other TRACE reportable securities, such firms would also have higher reporting costs. If those firms trade U.S. Treasury securities, their implementation costs are included in the Commission's estimates above and they will incur only the additional marginal costs caused by their volume in other TRACE-reportable securities. However, to the extent that some non-FINRA member firms trade in other TRACE reportable securities but not U.S. Treasury securities, those firms will each incur implementation costs as described above. The Commission cannot estimate how many firms are in this group of non-FINRA member firms that trade TRACE-reportable securities but not U.S. Treasury securities because the Commission can identify non-FINRA member counterparties in TRACE only for U.S. Treasury securities transactions that occur on covered ATSs, as discussed previously.[422]

TABLE 5—AVERAGE FIRM TRACE REPORTING IMPLEMENTATION COSTS

Cost	Median or average [1]
FIX Port Fee	$575
Direct Circuit Connectivity Fee for TRACE Reporting through Nasdaq	1,500

[413] *See* Group One Letter at 3.

[414] For example, Rule 17d–1 authorizes the Commission to name a single SRO as the DEA to examine a common SRO member. Rule 17d–2 permits SROs to propose joint plans among two or more SROs for the allocation of regulatory responsibility with respect to their common members. *See supra* section III.A.

[415] *See* CTC Letter at 4 (''estimates the one-time costs to join FINRA, and the ongoing annual compliance costs for FINRA membership, to each be millions of dollars''), and FIA PTG Letter at 4 (''it is very difficult to estimate the annual cost, but we would not be surprised if it is greater than $1,000,000 per year for some firms''). These estimates are higher than those presented by the Commission in Table 4, in part because these estimates do not incorporate FINRA's TAF relief amendment. As the estimates in Table 4 are only for the 12 largest non-FINRA member firms, the cost for the average non-FINRA member firm is expected to be much lower.

[416] *See, e.g.,* ABCV Letter at 2; Cboe Letter at 7; CTC Letter at 4; FIA PTG Letter at 4; Group One Letter at 3; Nasdaq Letter at 2; STA Letter at 4; Virtu Letter at 5.

[417] *See, e.g.,* ABCV Letter at 2; Cboe Letter at 7; CTC Letter at 4; FIA PTG Letter at 4; Group One Letter at 3; Nasdaq Letter at 3; PEAK6 Letter at 4–5; STA Letter at 4.

[418] *See* MMI Letter at 3.

[419] *See* FIA PTG Letter at 4.

[420] TRACE charges a Transaction Reporting Fee for TRACE reported securities other than U.S. Treasury securities. The fee is as follows: $0.475/trade for trade size up to and including $200,000 par value; $0.000002375 times the par value of the transaction (*i.e.,* $0.002375/$1000) for trade size over $200,000 and up to and including $999,999.99 par value; $2.375/trade for trade size of $1,000,000 par value or more.

[421] *See* FINRA Rule 7730, *available at https://www.finra.org/rules-guidance/rulebooks/finra-rules/7730.* Firms may incur additional fees for trade cancellations or corrections.

[422] *See supra* section V.A.1.

TABLE 5—AVERAGE FIRM TRACE REPORTING IMPLEMENTATION COSTS—Continued

Cost	Median or average [1]
Total	2,025

[1] Medians are used where possible. Direct Circuit Connection Fees can be found at *http://nasdaqtrader.com/Trader.aspx?id=PriceListTrading2*.

TABLE 6—AVERAGE FIRM TRACE REPORTING ONGOING ANNUAL COSTS

Cost	Median or average [1]
Systems Fees	$4,800
Data Fee	90,000
Nasdaq Connection Fee	30,000
Rule 7730 Service Fee	300
Total	125,100

[1] The systems fee is calculated using Level II Full Service Web Browser Access fee for four datasets at $140 a month plus a subscription for four additional user IDs at $260 per month for a total of $400 per month multiplied by 12 months, for an annual systems fee of $4,800. Data Fees are calculated using $7,500 per month flat fee for the professional real time data display. Connectivity fee is calculated at $2,500 a month for an annual cost of $30,000. Fees can be found at *https://www.finra.org/rules-guidance/rulebooks/finra-rules/7730*. Nasdaq FIX connection fees can be found at *http://nasdaqtrader.com/Trader.aspx?id=PriceListTrading2*.

d. Costs of Joining Additional Exchanges Under the Rule as Amended

Under the amendments, non-FINRA member firms must be members of all exchanges upon which they transact business if they decide not to join an Association. With limited exceptions for certain off-exchange activity, some non-FINRA member firms might choose to join additional exchanges to be excluded from the requirement to become a member of an Association. Alternatively, these firms might cease trading on exchanges of which they are not members.

Based on discussions with FINRA and industry participants, the Commission understands that completing a membership application with an additional exchange is generally less complicated and time consuming than completing a membership application with FINRA. The compliance burden on non-FINRA member firms for joining an additional exchange is likely to be significantly less than that of joining FINRA as those non-FINRA member firms that choose to join an additional exchange are likely able to perform this work internally, given that they are already members of at least one exchange, and that such work should take less time than the time required to complete an application with FINRA. However, the aggregate cost of joining multiple exchanges would likely be more costly than the cost of joining FINRA.

In addition to the registration costs, non-FINRA member firms joining additional exchanges as a result of the amendments will incur membership and related fees. To the extent that non-FINRA member firms choose to become members of additional exchanges, the fees associated with such memberships will vary depending on the type of access sought and the exchanges of which non-FINRA member firms choose to become members.

The exchange membership fees that apply to non-FINRA member firms joining such exchanges will be those fees that apply to either introducing brokers or dealers or proprietary trading firms. This assumption is consistent with the fact that any brokers or dealers carrying customer accounts could not qualify for the current exemption of Rule 15b9–1. Thus, any exchange membership fees that apply to firms that provide clearing services or conduct a public business would not apply to non-FINRA member firms.

Furthermore, because all non-FINRA member firms are members of at least one exchange,[423] they will have already completed a Form U4, to register associated persons.[424] Non-FINRA member firms will not need to register additional associated persons because the exchange SRO rules already require them to register associated persons. All exchanges can access the Form U4 filings within the CRD which is maintained by FINRA.

The estimates of the cost of joining additional exchanges are based on a review of membership-related fee structures of all twenty-four national securities exchanges. The view that the potential burden of joining additional exchanges will likely be less than that of joining FINRA includes the assumption that the costs imposed on non-FINRA member firms by the amendments will be membership fees, and not costs relating to trading, such as trading permit fees and connectivity fees. The Commission recognizes that membership alone in an exchange may not guarantee the ability to trade because many exchanges charge fees for trading rights, ports, various degrees of connectivity, and floor access and equipment, should those be desired. The fees associated with trading on an exchange are not the result of the amendments because, under the amendments, a non-FINRA member firm might continue to trade through another broker or dealer on an exchange as long as that non-FINRA member firm is a member of every exchange on which it trades or is a member of FINRA. In other words, the amendments themselves do not impose the cost of connectivity and related fees, but only the costs associated with membership on exchanges on which non-FINRA member firms could trade. To the extent, therefore, that non-FINRA member firms continue to trade through other brokers or dealers in a manner consistent with how they currently operate, the amendments impose only the costs associated with membership.

The estimates of the cost of joining additional exchanges aggregate all fees associated with a firm's initial application to an exchange (''initial fee'') and separately aggregated the fees associated with any monthly or annual membership costs to obtain a separate annual cost (''annual fee''). Based on these aggregations, a range for both the initial fee and the annual fee across exchanges is obtained. The initial fee is as low as $0 for some exchanges. Most exchanges have an initial fee that is greater than $0 and no more than $5,000.[425]

Regarding monthly or annual membership fees, most exchanges'

[423] For a broker or dealer to possibly be exempt from the requirement to be an Association member currently or under the amendments, the broker or dealer must be a member of at least one exchange.

[424] Form U4 is the Uniform Application for Securities Industry Registration or Transfer. Representatives of brokers and dealers, investment advisers, or issuers of securities use Form U4 to become registered in the appropriate jurisdictions and/or with SROs. All SROs currently use Form U4. *See, e.g.,* Cboe BYX Rule 2.5 Interpretations and Policies .01(c), and Nasdaq PHLX Rule General 3, section 7.

[425] IEX does not assess any initial fees. *See* IEX Exchange Fee Schedule, *available at https://exchange.iex.io/resources/trading/fee-schedule/* (last visited July 20, 2023) (omitting any mention of an initial membership fee). Other exchanges do have initial application fees. *See, e.g.,* Nasdaq ISE Fee Schedule, Options 7, section 9, *available at https://listingcenter.nasdaq.com/rulebook/ise/rules/ise-options-7* (last visited July 20, 2023) (assessing a one-time application fee of $3,500 for an ''Electronic Access Member''); Membership Application for New York Stock Exchange LLC and NYSE American LLC at 2 (Oct. 2019), *available at https://www.nyse.com/publicdocs/nyse/markets/nyse/NYSE_Application_for_Membership.pdf* (last visited July 20, 2023) (discussing the Non-Public Firm Application Fee of $2,500); Nasdaq Price List, *available at http://www.nasdaqtrader.com/Trader.aspx?id=PriceListTrading2* (last visited July 20, 2023) (discussing the Nasdaq Application Fee of $2,000); Cboe Fee Schedule at 10 (June 30, 2022), *available at https://cdn.cboe.com/resources/membership/Cboe_FeeSchedule.pdf* (last visited July 20, 2023) (typically assessing a trading permit holder organization application fee on all of its members of $5,000). If a firm is organized as a sole proprietorship, the application fee for Cboe is only $3,000. *Id.*

ongoing monthly or annual membership fees generally range from $1,500 to $7,200.[426] Again, these ongoing exchange membership costs are generally much lower than the annual costs estimated for being a member of FINRA.

The costs of the amendments associated with joining additional exchanges are included in the total cost estimates for joining an Association provided above in this section.[427] This is because, in the event that a non-FINRA member firm chooses to join one or more exchanges and not become a FINRA member, that firm would not incur any of the costs for joining an Association. The Commission believes that a firm may make this choice when the costs of joining FINRA exceed the costs of joining additional exchanges to cover all of the exchanges on which they currently trade. Consequently, the costs for such firms are expected to be no higher than the costs they are estimated to incur in joining FINRA. Thus, all firms will either join FINRA and incur the costs described above or join one or more exchanges and instead incur costs no higher than those described above, so that the total Association costs can be taken as an upper bound on the total costs over both possibilities.

e. Policies and Procedures Related to the Narrowed Criteria for Exemption From Association Membership

Non-FINRA member firms that choose not to join an Association but wish to continue to trade off-exchange (or on exchanges of which they are not members) must do so in a manner that conforms to the routing or stock-option order exemptions. To rely on the stock-option order exemption, the amendments will require non-FINRA member firms to establish, maintain, and enforce policies and procedures as discussed above.[428] The Commission estimates that firms would incur a burden of 8 hours in initially preparing these policies and procedures.[429] Furthermore, the burden of maintaining and enforcing such policies and procedures, including a review of such policies at least annually, will be approximately 48 hours.[430] The Commission estimated an initial implementation cost of approximately $2,561 and an annual ongoing cost of approximately $15,708 for non-FINRA member firms that wish to utilize the exemptions and perform this work internally; for firms that outsource this work, costs are likely to be higher.[431] Firms that choose to join FINRA will not incur these costs as the exemptions would not be relevant.

f. Indirect Costs

In addition to possibly incurring costs related to joining exchanges, non-FINRA member firms that choose not to join an Association will lose the benefits of trading in off-member-exchange markets. As mentioned above, non-FINRA member firms are significant participants in off-exchange activity. Much of this trading is attributed to 12 non-FINRA member firms, and the activity level across those firms varies widely. The Commission estimates that those 12 non-FINRA member firms executed $391 billion in off-exchange equity volume in September 2022, while the remaining non-FINRA member firms executed $49 billion. The Commission cannot estimate the likelihood of these firms choosing to cease off-exchange activity rather than joining an Association. However, given the large volume in off-exchange equity volume traded by non-FINRA members, the Commission believes that the probability of non-FINRA members ceasing off-exchange activity is very small.

Finally, those firms that choose not to join an Association would be limited in their ability to route their own transactions to comply with the requirements of Regulation NMS and the Options Linkage Plan.[432] Their transactions will have to be routed by an exchange of which they are a member or routed by a broker-dealer exclusively to exchanges of which they are members. This loss in choice could lead to higher costs for routing and costs associated with increased latency because the exchange's routing broker-dealer may have a telecommunications infrastructure that is inferior to that of the broker-dealer that previously provided connectivity between the exchange and the non-FINRA member firm.[433]

D. Alternatives

1. Include a Floor Member Hedging Exemption

The Commission could provide an exemption from Association membership if a dealer that meets the criteria of paragraphs (a) and (b) of the rule, conducts business on the floor of a single exchange, and its trading elsewhere is proprietary and solely for the purpose of hedging its floor-based exchange trading activity on its member exchange. The hedging exemption might be limited to firms that trade on the floor of a national securities exchange. Specifically, the alternative would provide that a dealer that conducts business on the floor of only a single national securities exchange may affect transactions in securities otherwise than on that exchange, for the dealer's own account with or through another registered broker or dealer, that are solely for the purpose of hedging the risks of its floor-based exchange activity, by reducing or otherwise mitigating the risks thereof. This alternative also could require a dealer seeking to rely on this exemption to establish, maintain, and enforce written policies and procedures

[426] *See, e.g.,* Cboe BYX Exchange, Inc. Fee Schedule (eff. Nov. 1, 2022), *available at https://www.cboe.com/us/equities/membership/fee_schedule/byx/* (last visited July 20, 2023) (noting an annual membership fee of $2,500); Cboe EDGA Exchange, Inc. Fee Schedule (eff. Nov. 30, 2022), *https://www.cboe.com/us/equities/membership/fee_schedule/edga/* (last visited July 20, 2023) (same); NYSE Chicago, Inc. Fee Schedule (updated Jan. 3, 2023), *available at https://www.nyse.com/publicdocs/nyse/NYSE_Chicago_Fee_Schedule.pdf* (last visited July 20, 2023) (assessing an annual membership fee of $7,200); MIAX Fee Schedule at 20 (Sept. 1, 2022), *available at https://www.miaxoptions.com/sites/default/files/fee_schedule-files/MIAX_Options_Fee_Schedule_09012022.pdf* (last visited July 20, 2023) (assessing a monthly trading permit fee for an ''Electronic Exchange Member'' of $1,500).

[427] *See supra* note 383.

[428] *See supra* section III.B.2.

[429] This figure is based on the following: (Compliance Manager at 5 hours) + (Compliance Attorney at 2.5 hours) + (Director of Compliance at 0.5 hours) = 8 burden hours per dealer. *See infra* note 446. As is discussed in more detail in the Paperwork Reduction Act discussion, the Commission based this estimate on the estimated burdens imposed by other rules applicable to brokers and dealers, such as Regulation SBSR. *See also infra* note 447.

[430] This figure is based on the following: (Compliance Manager at 30 hours) + (Compliance Attorney at 12 hours) + (Director of Compliance at 6 hours) = 48 burden hours per broker or dealer. *See infra* note 448.

[431] For firms that perform this work internally, the initial cost estimate assumes 5 hours of work performed by a Compliance Manager at an hourly rate of $293, 2.5 hours performed by Compliance Attorneys at an hourly rate of $346, and 0.5 hour of work performed by the Director of Compliance at an hourly rate of $461. The annual cost estimate assumes 30 hours of work by a Compliance Manager at an hourly rate of $293, 12 hours by Compliance Attorneys at an hourly rate of $346, and 6 hours by the Director of Compliance at an hourly rate of $461. Hourly salary figure is from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800 hour work-year and inflation and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

[432] The exemption related to routing to comply with Regulation NMS and the Options Linkage Plan is discussed in *supra* section III.B.1.

[433] Firms in the business of providing connectivity to exchanges are likely to compete on the basis of their technology. The Commission assumes that some firms that do not join FINRA will have some orders (those governed under the Regulation NMS or the Options Linkage Plan provisions to prevent trade-throughs) routed using technology inferior to the technology of their firm of choice.

reasonably designed to ensure and demonstrate that such hedging transactions reduce or otherwise mitigate the risks of the financial exposure the dealer incurs as a result of its floor-based activity, and to preserve a copy of its policies and procedures in a manner consistent with 17 CFR 240.17a–4 until three years after the date the policies and procedures are replaced with updated policies and procedures.

The Commission believes that this alternative could provide a limited exemption from Association membership that is consistent with the original design of Rule 15b9–1's exclusion for proprietary trading. Today, few dealers limit their quoting and other non-hedging trading activities to a particular exchange. Under this alternative, the registered dealers among this group that limit their primary trading business to a single exchange floor may continue to hedge the risk of that business by effecting securities transactions on another exchange or in the off-exchange market that are solely for the purpose of hedging the dealers' on-exchange activity, without such transactions triggering a requirement to join an Association.

The Commission also believes that this alternative approach, and in particular the limitation of its coverage to dealers that engage in floor trading and are a member of only a single exchange, could be consistent with the public interest and the protection of investors. A dealer's hedging activity resulting from its trading activity on multiple exchanges of which the dealer is a member presents cross-market surveillance concerns as previously discussed, and therefore FINRA would be in the best position to conduct regulatory oversight to the extent that the dealer's hedging transactions take place elsewhere than on exchanges of which it is a member. By contrast, so long as a dealer's hedging activity results from floor trading activity that is confined to a single exchange of which the dealer is a member, that exchange could be able to adequately supervise the hedging activities of the dealer, consistent with the public interest and protection of investors.

In addition, requiring written policies and procedures, as described above, would facilitate exchange supervision of dealers relying on such floor member hedging exemption, as it could provide an efficient and effective way for the relevant exchange to assess compliance with the proposed exemption. This could further serve the public interest and help protect investors.

Because the alternative hedging exemption for floor traders is intended to allow a dealer to reduce or otherwise mitigate its risk, such as position risk, incurred in connection with its exchange-based dealer activities, it would be limited to transactions for the dealer's own account. In addition, because the dealer would not itself be a member of any other national securities exchange on which hedging transactions may be effected, or of an Association, such transactions would need to be conducted with or through another registered broker or dealer that is a member of such other national securities exchange or a member of an Association (or of both). However, the Commission believes that this alternative exemption would currently apply to very few and as little as zero non-FINRA member firms. Given that so few non-FINRA member firms would qualify for the exemption, the Commission believes that there is little value in including such an exemption.

2. Exchange Membership Alternative

The amendments, in accordance with section 15(b)(8), preclude any firm that is not a member of an Association from trading on exchanges of which it is not a member.[434] Further, under the amendments, if a firm becomes a member of an Association, it would not have to become a member of each exchange upon which it trades.[435] The Commission has also considered requiring brokers and dealers to become a member of every exchange on which they trade and to become a member of an Association to trade off-exchange (''Exchange Membership Alternative'').

In considering the Exchange Membership Alternative, the Commission weighed whether the same issue of off-exchange activity not being subject to effective regulatory oversight that exists when a non-FINRA member firm trades off-exchange is present when a member or non-FINRA member firm trades on an exchange of which it is not a member (through a member of that exchange). The Commission continues to believe that the amendments adequately address the issue of establishing effective oversight of off-exchange activity and that the more onerous Exchange Membership Alternative would not provide any additional regulatory benefit beyond the benefits the amendments provide for several reasons. First, while some exchanges may lack specialized regulatory personnel to directly surveil their members' trading off-exchange, FINRA has these resources to surveil the activity of member firms both on exchanges and off-exchange. Accordingly, requiring member firms to also become members of each exchange on which they effect transactions, including indirectly, would be unnecessarily duplicative because FINRA already has the resources necessary to surveil the activity of a member firm trading on an exchange of which it is not a member. In addition, while some exchanges do not have a specialized rule set to govern their members' activity in the off-exchange market, FINRA's rules are often consistent with the trading rules of exchanges on which members transact. If a member firm were to violate an exchange rule on an exchange of which it is not a member, FINRA would have the jurisdiction needed to address the resulting violation. Therefore, not requiring that the member firm also become a member of that exchange would not prevent FINRA from exercising jurisdiction over the matter.

The Exchange Membership Alternative might have required firms to become members of more SROs than required under the amendments, which would impose additional costs. In particular, some non-FINRA member firms that would become member firms under the amendments would also need to become members of additional exchanges or cease trading on those exchanges. In addition, some current member firms would also need to become members of additional exchanges.

3. Retaining the *De Minimis* Allowance

The Commission considered retaining the $1,000 *de minimis* allowance for trading other than on an exchange of which the non-FINRA member firm is a member but removing the exception for proprietary trading conducted with or through another registered broker or dealer. As discussed above,[436] the Commission continues to believe that the magnitude of the *de minimis* allowance is no longer economically meaningful.[437] Furthermore, the

[434] The amendments provide limited exemptions for order routing to satisfy certain provisions of Regulation NMS and the Options Linkage Plan and for executing the stock leg of a stock-option order.

[435] In order to trade on exchanges of which it is not a member, the firm would have to trade with or through another broker or dealer that is a member of that exchange.

[436] *See supra* section III.A.

[437] FINRA agreed that the *de minimis* exception should be eliminated in part because ATSs are ''typically interposed between [non-members] and other ATS subscribers, non-member PTFs can engage in substantial OTC trading, including with orders from ATS subscribers or other broker-dealers, without technically triggering the gross income limitation.'' *See* FINRA Letter at 3.

Commission continues to believe that the commission sharing arrangements discussed previously[438] are rarely, if ever, used.

4. Eliminate the Rule 15b9–1 Exemption

The Commission could eliminate Rule 15b9–1 altogether, leaving no exemption from section 15(b)(8) of the Act. This would cause all current non-FINRA member firms that effect off-member-exchange securities transactions to be required by section 15(b)(8) to join FINRA, which could improve FINRA's ability to surveil activity of member firms off-member-exchange, as well as investigate potentially violative behavior.[439] This improvement in FINRA's abilities may not be large relative to the adopted amendments due to the fact that the adopted exemptions are narrow. However, eliminating the exemption for firms that would qualify for the routing exemption or the stock-option order exemption may prove to unnecessarily increase the costs for such firms. The Commission also believes that the routing exemption and stock-option order exemption will provide important avenues for providing liquidity and, therefore, eliminating the exemptions may drive these firms from the market and lead to a reduction in liquidity and market quality.

5. Mandate TRACE U.S. Treasury Securities Reporting Without Requiring Association Membership

In order to address the reporting gap within U.S. Treasury securities trading by non-FINRA members, the Commission could require that all last sale U.S. Treasury securities transaction data be reported to and disseminated by TRACE. Some commenters suggested that this reporting requirement could improve transparency in the U.S. Treasury securities markets without imposing costs of Association membership.[440]

However, since U.S. Treasury securities trade predominantly off-exchange, the Commission believes that U.S. Treasury securities markets will benefit from enhanced regulatory supervision that comes with Association membership.[441] FINRA stated that although non-FINRA member broker-dealers and non-broker-dealer firms were identified in 17 percent of the surveillance alerts generated by FINRA's Treasuries manipulation patterns in 2020 and 2021, FINRA has no authority to address any potential market misconduct by non-FINRA members in these instances.[442] Accordingly, the Commission agrees that Association membership will benefit U.S. Treasury securities and other fixed income markets under these circumstances by providing more effective oversight relative to the alternative of simply mandating TRACE reporting.

VI. Paperwork Reduction Act

Certain provisions of the proposed amendments to Rule 15b9–1 contain ''collection of information requirements'' within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[443] The Commission requested comment on the collection of information requirements in the 2022 Re-Proposal and submitted relevant information to the Office of Management and Budget (''OMB'') for review in accordance with the PRA and its implementing regulations.[444] The title of this new collection of information is ''Rule 15b9–1 Exemptions.'' An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the agency displays a currently valid OMB control number. The Commission has received an OMB control number (3235–0743) for this collection of information. As discussed in section III.B, the amendments to Rule 15b9–1 require brokers or dealers relying on the stock-option order exemption to establish, maintain, and enforce certain written policies and procedures. Compliance with these collection of information requirements is mandatory for firms relying on the amended rule. The Commission received no comments on the estimates for the collection of information requirements included in the 2022 Re-Proposing Release.

A. Summary of Collection of Information

The amendments to Rule 15b9–1 include a collection of information within the meaning of the PRA for brokers or dealers relying on the stock-option order exemption under the amended rule. The stock-option order exemption under the amendments to Rule 15b9–1 permits a qualifying broker or dealer to effect off-member-exchange securities transactions, with or through another broker or dealer, that are solely for the purpose of executing the stock leg of a stock-option order. Brokers or dealers relying on this exemption are required to establish, maintain, and enforce written policies and procedures reasonably designed to ensure and demonstrate that such transactions are solely for the purpose of executing the stock leg of a stock-option order. In addition, such brokers or dealers are required to preserve a copy of their policies and procedures in a manner consistent with Rule 17a–4 until three years after the date the policies and procedures are replaced with updated policies and procedures.

B. Proposed Use of Information

The policies and procedures required under amended Rule 15b9–1 will be used by the Commission and SROs to understand how brokers and dealers relying on the exemption evaluate whether the off-member-exchange securities transactions that they effect are solely for the purpose of executing the stock leg of a stock-option order and, more generally, how such brokers and dealers are complying with the requirements of the exemption and Rule 15b9–1. These policies and procedures will be used generally by the Commission as part of its ongoing efforts to examine and enforce compliance with the Federal securities laws, including section 15(b)(8) of the Act and Rule 15b9–1 thereunder. In addition, SROs may use the information to monitor and enforce compliance by their members with applicable SRO rules and the Federal securities laws.

C. Respondents

The Commission believes that a small number of brokers or dealers will rely on the stock-option order exemption. The Commission estimates that, based on publicly available information reviewed covering the end of April 2023, there are approximately 64 broker-dealers registered with the Commission that are members of an exchange but not members of an Association. The Commission believes that some, but not all, of these broker-dealers will likely

[438] *See supra* note 33.

[439] One commenter suggested, as an alternative to the amendments, that the Commission could impose ''a more limited FINRA membership that would provide for limited oversight covering the reporting of over-the-counter transactions to FINRA and related surveillance'' if said exemption were to be eliminated. *See* Virtu Letter at 3.

[440] *See* CTC Letter at 3; FIA PTG Letter at 3; Virtu Letter at 2.

[441] Although most trading in U.S. Treasury securities is reported to TRACE and therefore surveilled by FINRA, this surveillance is not equivalent to the more extensive oversight that FINRA has over its members. Therefore, when FINRA encounters potentially problematic conduct by firms that are not FINRA members, its ability to investigate potential violations of, or enforce compliance with Federal securities laws, Commission rules, or FINRA rules is limited. See discussion in supra section III.A.

[442] *See* FINRA Letter at 10; *supra* note 119; *see also* Better Markets Letter at 7.

[443] 44 U.S.C. 3501 *et seq.*

[444] 44 U.S.C. 3507; 5 CFR 1320.11.

choose to avail themselves of the stock-option order exemption, because not all of them handle stock-option orders or, for those that do handle stock-option orders, they may effect the execution of stock leg components of those orders on an exchange where they are a member. The Commission estimates that 17 firms could potentially rely on the stock-option order exemption and would therefore be required to comply with the policies and procedures requirement.[445] The Commission believes that some of these 17 firms could want the ability to effect off-member-exchange securities transactions that are not for the purpose of executing the stock leg of a stock-option order, and may, accordingly, choose to join an Association as a result of the amendments to Rule 15b9–1.

D. Total Initial and Annual Reporting and Recordkeeping Burdens

The Commission estimates that the one-time, initial burden for a broker or dealer to establish written policies and procedures as required under amended Rule 15b9–1 will be approximately 8 hours.[446] This figure is based on the estimated number of hours to develop a set of written policies and procedures, including review and approval by appropriate legal personnel. The policies and procedures in the amended rule are limited to those transactions that are solely for the purpose of executing the stock leg of a stock-option order. In addition, the Commission estimates that the annual burden of maintaining and enforcing such policies and procedures, including a review of such policies at least annually, will be approximately 48 hours for each broker or dealer.[447] This figure includes an estimate of hours related to reviewing existing policies and procedures, making necessary updates, conducting ongoing training, maintaining relevant systems and internal controls, performing necessary testing and monitoring of stock-leg transactions as they relate to the broker's or dealer's activities and maintaining copies of the policies and procedures for the period of time required by the amended rule.

The Commission estimates that the initial, first year burden associated with amended Rule 15b9–1 will be 56 hours per broker or dealer, which corresponds to an initial aggregate burden of 952 hours.[448] The Commission estimates that the ongoing annualized burden associated with Rule 15b9–1 will be 48 hours per broker or dealer, which corresponds to an ongoing annualized aggregate burden of 816 hours.[449]

E. Collection of Information is Mandatory

All of the collection of information discussed above is mandatory.

F. Confidentiality of Responses to Collection of Information

To the extent that the Commission receives confidential information pursuant to the collection of information, such information will be kept confidential, subject to the provisions of applicable law.[450]

G. Retention Period for Recordkeeping Requirements

Brokers or dealers seeking to take advantage of the stock-option order exemption will be required to preserve a copy of their policies and procedures in a manner consistent with Rule 17a–4 [451] until three years after the date the policies and procedures are replaced with updated policies and procedures.

VII. Regulatory Flexibility Act Certification

The RFA requires that Federal agencies, in promulgating rules, consider the impact of those rules on small entities.[452] Section 3(a) of the RFA requires the Commission to undertake a regulatory flexibility analysis of the impact of the rule amendments on small entities unless the Commission certifies that the rule amendments would not have a significant economic impact on a substantial number of small entities.[453] For purposes of Commission rulemaking in connection with the RFA,[454] a small entity includes a broker or dealer that: (1) had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to 17 CFR 240.17a–5(d) (''Rule 17a–5(d)''),[455] or, if not required to file such statements, a broker or dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization.[456]

In the 2022 Re-Proposal, after an examination of FOCUS data for the then-active broker-dealers registered with the Commission, the Commission certified, pursuant to section 605(b) of the RFA, that amended Rule 15b9–1 would not, if adopted, have a significant impact on a substantial number of small entities.[457] One commenter disagreed with the Commission's certification, stating that there are 39 non-FINRA members of Nasdaq exchanges, 13 of which are overseen by Nasdaq PHLX LLC as the DEA.[458] The commenter further stated that certain of those members trade off-exchange and would not be eligible for the re-proposed exemptions in amended Rule 15b9–1, and that the economic impact of the rule amendments on these members would

[445] *See supra* section III.B.2.

[446] This figure is based on the following: (Compliance Manager at 5 hours) + (Compliance Attorney at 2.5 hours) + (Director of Compliance at 0.5 hour) = 8 burden hours per broker or dealer.

[447] This figure is based on the following: (Compliance Manager at 30 hours) + (Compliance Attorney at 12 hours) + (Director of Compliance at 6 hours) = 48 burden hours per broker or dealer.

[448] This figure is based on the following: ((8 burden hours per broker or dealer) + (48 burden hours per broker or dealer)) × (17 brokers and dealers) = 952 burden hours during the first year. In estimating these burden hours, the Commission also examined the estimated initial and ongoing burden hours imposed on registered security-based swap dealers under Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information. *See* Securities Exchange Act Release No. 74244 (Feb. 11, 2015) 80 FR 14564, 14683 (Mar. 19, 2015) (''Regulation SBSR''). Regulation SBSR requires registered security-based swap dealers to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure compliance with any security-based swap transaction reporting obligations. *Id.* The estimated initial and ongoing compliance burden on registered security-based swap dealers under Regulation SBSR were 216 burden hours and 120 burden hours, respectively. *Id.* The policies and procedures under amended Rule 15b9–1 are much more limited in nature.

[449] This figure is based on the following: (48 burden hours per broker or dealer) × (17 brokers and dealers) = 816 ongoing, annualized aggregate burden hours.

[450] *See, e.g.,* 5 U.S.C. 552 *et seq.;* 15 U.S.C. 78x (governing the public availability of information obtained by the Commission).

[451] 17 CFR 240.17a–4. Registered brokers and dealers are already subject to existing recordkeeping and retention requirements under Rule 17a–4. However, amended Rule 15b9–1 contains a requirement that a broker or dealer relying on the stock-option order exemption preserve a copy of its policies and procedures in a manner consistent with Rule 17a–4 until three years after the date the policies and procedures are replaced with updated policies and procedures. The burdens associated with this recordkeeping obligation have been accounted for in the burden estimates discussed above for amended Rule 15b9–1.

[452] 5 U.S.C. 601 *et seq.*

[453] 5 U.S.C. 605(b).

[454] Although section 601(b) of the RFA defines the term ''small entity,'' the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term ''small entity'' for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this rulemaking, are set forth in 17 CFR 240.0–10 (Rule 0–10 under the Exchange Act). *See* Securities Exchange Act Release No. 18451 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982) (File No. AS–305).

[455] Rule 17a–5(d) under the Exchange Act.

[456] *See* 17 CFR 240.0–10(c).

[457] *See* 5 U.S.C. 605(b). *See also* 2022 Re-Proposal, *supra* note 1, 87 FR 49972–73.

[458] *See* Nasdaq Letter at 4.

be significant based on the Commission's estimate of the costs of FINRA membership.[459] However, the commenter did not specify whether any of its 39 non-FINRA members are small entities under RFA standards or identify those non-FINRA members. Specifically, the commenter did not assert that any of these non-FINRA members have total capital of less than $500,000 and are not affiliates of any person (other than a natural person) that is not a small business or small organization.

The Commission re-examined recent FOCUS data for the approximately 3,500 active broker-dealers registered with Commission as of April 2023, including the 64 non-FINRA member broker-dealer firms that the Commission identified as of April 2023.[460] Based on this re-examination, the Commission estimates that not more than three of the non-FINRA member broker-dealer firms have total capital of less than $500,000 and are not affiliates of any person (other than a natural person) that is not a small business or small organization and would, as a result, be considered small entities under RFA standards. These three small firms could be significantly impacted by the adopted rule amendments because they could be required to become a member of FINRA under section 15(b)(8) of the Act, if they effect off-member-exchange securities transactions and do not qualify for one of the adopted exemptions.[461]

Of the approximately 3,500 broker-dealers registered with the Commission, 786 qualify as small entities because they have total capital of less than $500,000 and are not affiliates of any person (other than a natural person) that is not a small business or small organization.[462] Since three of these small broker-dealer entities were not FINRA members as of April 2023, the Commission estimates that approximately 783 of these small broker-dealer entities are already registered with FINRA. The activities of these 783 FINRA member broker-dealers could be impacted by the amendments to Rule 15b9–1 because the amendments have changed the terms upon which they could deregister from FINRA. Specifically, they will not be able to deregister with FINRA unless they comply with Rule 15b9–1, as amended, which, compared to the pre-amendment rule, sets forth much narrower grounds upon which a broker-dealer may be exempt from FINRA membership. Because the Commission estimates that not more than three small entities will be significantly impacted by the amendments to Rule 15b9–1, compared to 786 total small entities that could be impacted by the rule amendments, the Commission does not believe that a substantial number of small entities will be significantly impacted by the amendments to Rule 15b9–1. Therefore, the Commission certifies that the amendments to Rule 15b9–1 will not have a significant economic impact on a substantial number of small entities.

VIII. Other Matters

If any of the provisions of this rule, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

Pursuant to the Congressional Review Act, the Office of Information and Regulatory Affairs has designated these rules as not a major rule, as defined by 5 U.S.C. 804(2).

Statutory Authority

The Commission is adopting the final amendments contained in this release under the authority set forth in the Exchange Act, 15 U.S.C. 78a *et seq.,* and particularly sections 3, 15, 15A, 17, 19, 23, and 36 thereof.

List of Subjects in 17 CFR Part 240

Brokers, Dealers, Registration, Securities.

Text of Amendments

For the reasons set out in the preamble, the Commission is amending title 17, chapter II of the Code of Federal Regulations as follows.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c–3, 78c–5, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78j–4, 78k, 78k–1, 78*l,* 78m, 78n, 78n–1, 78*o,* 78*o*–4, 78*o*–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78dd, 78*ll,* 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, 7201 *et seq.,* and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111–203, 939A, 124 Stat. 1376 (2010); and Pub. L. 112–106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

■ 2. Section 240.15b9–1 is revised to read as follows:

§ 240.15b9–1 Exemption for certain exchange members.

Any broker or dealer required by section 15(b)(8) of the Act (15 U.S.C. 78*o*(b)(8)) to become a member of a registered national securities association shall be exempt from such requirement if it:

(a) Is a member of a national securities exchange;

(b) Carries no customer accounts; and

(c) Effects transactions in securities solely on a national securities exchange of which it is a member, except that with respect to this paragraph (c):

(1) A broker or dealer may effect transactions in securities otherwise than on a national securities exchange of which the broker or dealer is a member that result solely from orders that are routed by a national securities exchange of which the broker or dealer is a member to comply with § 242.611 of this chapter or the Options Order Protection and Locked/Crossed Market Plan; or

(2) A broker or dealer may effect transactions in securities otherwise than on a national securities exchange of which the broker or dealer is a member, with or through another registered broker or dealer, that are solely for the purpose of executing the stock leg of a stock-option order. A broker or dealer seeking to rely on this exception shall establish, maintain and enforce written policies and procedures reasonably designed to ensure and demonstrate that such transactions are solely for the purpose of executing the stock leg of a stock-option order. Such broker or dealer shall preserve a copy of its policies and procedures in a manner consistent with § 240.17a–4 until three years after the date the policies and procedures are replaced with updated policies and procedures.

By the Commission.

Dated: August 23, 2023.

Sherry R. Haywood,

Assistant Secretary.

[FR Doc. 2023–18658 Filed 9–6–23; 8:45 am]

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[459] *See id.*

[460] *See supra* section II.B.

[461] *See supra* section III. The costs of FINRA membership are discussed in detail section V, *supra.* In addition, section V.D, *supra,* discusses the alternatives considered by the Commission. As discussed *supra* in section III.A, these three firms are not among the 12 largest non-FINRA member broker-dealer firms identified by the Commission as of April 2023, and so, as discussed in that section as well as section V.C.2 *supra,* their initial and ongoing FINRA membership costs, should they join FINRA, likely would be low, suggesting that, while they would be significantly impacted if they are required to join FINRA as a result of the adopted rule amendments, their trading businesses nevertheless might not be materially impeded by the costs of FINRA membership.

[462] Data from FOCUS for Quarter 2 of 2023.