

November 30, 2007

Barbara Z. Sweeney
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street, N.W.
Washington, D.C. 20006-1506

Re: Regulatory Notice 07-46

Dear Ms. Sweeney:

We submit this letter on behalf of our clients, BNY ConvergeX Execution Solutions LLC, Charles Schwab & Co., Inc., National Financial Services LLC, and Pershing LLC (collectively, the "Commenting Firms"), in response to a request by the Financial Industry Regulatory Authority, Inc. ("FINRA") in Regulatory Notice 07-46 (the "Regulatory Notice") for comments on the trade reporting requirements applicable to over-the-counter transactions in listed and OTC equity securities. Our comments are limited to the Trade Reporting Structure Proposal in the Regulatory Notice. We appreciate the opportunity to comment on the Regulatory Notice.

I. Background

The reporting logic for the various trade reporting facilities ("TRFs"), and the single NASD trade reporting facility that preceded the TRFs, has long been a constant: (1) the sell-side reports transactions between two market-makers; (2) the market-maker reports transactions between a market-maker and a non market-maker; (3) the sell-side reports transactions between two non market-makers; and (4) the member firm reports transactions between a member firm and a non-member or customer.¹ As the Staff has recognized, it can be difficult in today's markets for a member firm to determine whether a counter-party is a market-maker.² Many member firms have a market-making and separate agency or proprietary trading desks, often with different market participant identifications ("MPIDs") that may result in confusion regarding the market-maker status of the firm. Counter-parties that receive orders from a member firm with an agency or proprietary trading desk often do not know, and may not be able to quickly determine, whether the member firm has a separate

¹ See NASD rules 4632(b) (FINRA/Nasdaq TRF); 4632A(b) (ADF); 4632C(b) (FINRA/NSX TRF); 4632E(b) (FINRA/NYSE TRF); and 6620(b) (OTC Reporting Facility).

² See Regulatory Notice, at 3.

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market-making desk and, if so, whether it makes a market in the relevant security. This is a common scenario for confusion, but there are others.

The Staff offers two proposals in the Notice "to create a simpler, more uniform trade reporting structure."³ The objective is "to adopt an approach that will result in more accurate and timely trade reporting and make the trade reporting process less cumbersome for firms."⁴ One is a "sell-side reporting structure," and the other is an "executing-broker reporting structure." According to the Staff:

- Under a "sell-side reporting structure," the sell-side of a transaction would always have the trade reporting obligation, except that the member firm would have the trade reporting obligation in any transaction between a member firm and a non member-firm or customer.⁵
- Under an "executing-broker reporting structure," the executing broker would always have the trade reporting obligation, except that the member firm would have the trade reporting obligation in any transaction between a member firm and a non member-firm or customer.⁶

While the "sell-side reporting structure" may be simpler from the perspective of FINRA, it makes things vastly more costly and less efficient for the member firms themselves. A "sell-side reporting structure" would result in a significant increase in the rate of unreported or inaccurately reported transactions because it will impose substantial trade-reporting obligations on member firms that do not currently have robust trade reporting systems. For the reasons discussed below, the Commenting Firms strongly urge the Staff to endorse the "executing-broker reporting structure" in any formal rulemaking proposal.

II. Discussion

A. The "Executing Broker Reporting Structure" is Significantly More Efficient for Member Firms

The identity of the executing broker is abundantly clear in all but a tiny fraction of OTC equity securities transactions. In today's markets, the overwhelming majority of OTC transactions result from orders routed electronically to a market center, whether such market center is an alternative trading system ("ATS") or market-maker, and whether such ATS or

³ Regulatory Notice, at 3.

⁴ Regulatory Notice, at 3.

⁵ Regulatory Notice, at 3.

⁶ Regulatory Notice, at 4.

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market-maker executes the order or routes it to another market center that executes the order.⁷ In such instances, the identity of the executing broker-dealer is abundantly clear. Provided the order is executable without further consent or confirmation from the order-originating firm, or any intermediate routing firm, the obligation to report any resulting transaction to the relevant TRF should rest with the party who is the final recipient and who determines the price of the transaction (the "Executing Broker").

Member firms that frequently act as an Executing Broker tend to have robust trade-reporting systems and procedures. Member firms that do not frequently act as an Executing Broker, conversely, tend not to have robust trade reporting systems and procedures. The same is true of desks that do not typically execute orders, even if such desks are part of a member firm that elsewhere functions as an Executing Broker. The adoption of an "executing-broker reporting structure" will impose the trade-reporting obligation on the member firms, and the desks at those member firms, that are best-equipped to report transactions in a timely and accurate fashion.

The elimination of uncertainty regarding the status or identity of the reporting party is an important objective that is best accomplished with an "executing broker reporting structure." The "executing broker reporting structure" removes any doubt about which party has the reporting obligation in the vast majority of OTC equity transactions. In all but a tiny handful of transactions, the party with the reporting obligation, the Executing Broker, is obvious to both sides of the trade. There are very few scenarios in which the identity of the Executing Broker will not be obvious to both sides of the transaction. Specifically:

- Telephone Trades: The identity of the Executing Broker may not be clear when a member firm executes a trade over the telephone with another member firm. This scenario — increasingly rare in the current marketplace — is easily resolved by deeming the receiving or responding firm to be the Executing Broker, a determination which poses less of an issue where the parties are already handling the trade manually by telephone.⁸
- Request-for-Quote-Driven Trades: The identity of the Executing Broker may not be clear when a member firm requests a quote from

⁷ In certain cases, orders are first routed to a non-market center order-entry firm, usually the clearing firm for the originating firm or a firm providing smart order-routing services, which then re-routes the order to a market center that executes the order.

⁸ In addition, in connection with any transaction to correct an error transaction between member firms, the member firm that was the Executing Broker in the error transaction should be deemed to be the Executing Broker in the correcting transaction.

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another member firm, receives a quote, and then agrees to a trade at the quoted price. In such a scenario, the requesting firm did not route an order to another member firm that was executable without further consent or confirmation. Instead, the requesting firm engaged in price discovery and entered a negotiated transaction. Any confusion is easily resolved by deeming the member firm responding to the request for quote (*i.e.*, the price-making firm) to be the Executing Broker.

Both scenarios are highly unusual in today's equities markets and are easily resolved, without confusion or delay, by deeming the receiving/responding or price-making broker to be the Executing Broker.⁹ This preference for the "executing broker reporting structure" is not limited to the Commenting Firms. Indeed, member firms have long entered into Uniform Trade Reporting Facility Service Bureau/Executing Broker Agreements or their predecessor, Attachment 2s/Attachment Cs (collectively, "TRF Agreements") to replicate the proposed "executing broker reporting structure."¹⁰ This widespread practice demonstrates the strong preference of member firms.

B. The "Sell-Side Reporting Structure" Would Cause Significant Difficulties for Member Firms

The adoption of a "sell-side reporting structure" would have severe, adverse consequences for order-entry firms and desks within member firms that are not currently required to report transactions. A "sell-side reporting structure" would force such firms to implement trade reporting systems, or to enter TRF Agreements with all of the member firms to which they route orders. This would come at a substantial cost. Even if they choose not to implement costly trade-reporting systems, and elect to enter into TRF Agreements with their Executing Brokers, they would still be required to monitor that the data submitted by their Executing Brokers is timely, accurate and complete. As the Staff is aware, member firms remain fully-responsible for ensuring that trades reported on their behalf are "in compliance with all

⁹ Confusion about whether a party is or is not a market-maker is unlikely in either scenario because the Order Entry Firms are in direct contact with each other. Unlike with electronically-routed orders, the Order Entry Firms are directly exchanging information and can easily determine which Order Entry Firm, if any, is a market-maker.

¹⁰ Member firms that are FINRA TRF participants and that have entered "Nasdaq AGU/Attachment 2 Agreements" are not required to enter TRF Agreements. Member firms, likewise, that are ADF participants and that have entered "ADF AGU/Attachment C Agreements" are not required to enter TRF Agreements. *See* Notice to All TRF, ADF and Other NASD Facility Participants Regarding AGU and QSR Relationships, Jan. 25, 2007 (available at <http://www.finra.org/rulesregulation/memberalerts/>) (the "Notice to TRF Participants").

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applicable rules and regulations," whether or not they report the trades themselves.¹¹ This means that the order-entry firms and non-executing desks of other member firms that continue to rely on their Executing Brokers to report trades — the likely preference of most — would have substantial added costs and responsibilities. Order-entry firms and the non-executing desks of other member firms that take on the trade-reporting function themselves would fare no better. They face the daunting costs of developing a robust trade reporting apparatus for their sell-side transactions, as well as difficult challenges under new regulations, including Regulation NMS. A member firm not involved in executing the transaction will not be in a position to know the Regulation NMS modifiers that need to be reported to the TRF. Neither option is cost-effective or efficient.

The negative impact of a "sell-side reporting structure" is not limited to order-entry firms and the non-executing desks of other member firms. Even the Executing Brokers would suffer significant adverse consequences. Executing Brokers have robust trade reporting systems in place. Executing Brokers are well-equipped to report all of the orders that are routed to them for execution, not merely those that they execute from the sell-side. Identifying and reporting only a subset of reportable transactions is not more efficient for Executing Brokers. It is less efficient. Instead of reporting all transactions from the perspective of the Executing Broker — a process for which their systems are designed — the Executing Broker must decipher and report only those transactions in which its counter-party (a) bought from the Executing Broker, or (b) has entered a TRF Agreement with the Executing Broker. In the event that the counter-party has entered a TRF Agreement with the Executing Broker, furthermore, the Executing Broker must report from the perspective of the selling member firm. This is a complex and nuanced process. Executing Brokers do not benefit from a reporting structure that requires them to constantly monitor external variables that differ from transaction to transaction. The end-result is a reporting structure that is much less-streamlined from the perspective of the Executing Broker.

The "executing-broker reporting structure" suffers from none of these inefficiencies. With an "executing-broker reporting structure," the Executing Broker would continue to report trades for order-entry firms and the non-executing desks of other member firms without the significant additional costs and liabilities that accompany a "sell-side reporting structure." Member firms would not be required to enter TRF Agreements with numerous OTC market centers, or to monitor the timeliness, accuracy and completeness of massive quantities of data submitted on their behalf. Executing Brokers, likewise, would not be required to adhere to a complicated reporting protocol that differs based upon whether they are buying or selling, and whether their counter-party has entered a TRF Agreement. Avoiding these difficulties is a significant advantage that will prevent massive costs and inefficiencies.

¹¹ Notice to TRF Participants, at 1.

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Nor does the "executing-broker reporting structure" sacrifice clarity or simplicity. All but a tiny fraction of orders in the current marketplace are routed electronically. This means that in the vast majority of transactions there is no doubt about which entity is the Executing Broker. When a member firm routes an order to an Executing Broker that is executable without further consent or confirmation, the Executing Broker reports. There are no questions. There is no need to determine whether one or both member firms is a market-maker. Trade reporting becomes a uniform, fully-automated process in the vast majority of instances.

III. Conclusion

The Commenting Firms urge the Staff to endorse the "executing-broker reporting structure" in any formal rulemaking proposal and recommend the "executing-broker reporting structure" over both the "sell-side reporting structure" and current TRF reporting logic. Any transaction that results from an order that is routed for execution by a member firm to another member firm, and that is executable without further consent or confirmation, should be reported by the Executing Broker. In the event that an order is not executable without further consent or confirmation, the receiving, price-making broker-dealer should be deemed to be the Executing Broker. This is by far the most cost-effective and efficient reporting structure.

* * *

We thank the Staff for its serious consideration of these comments. If the Staff has any questions about this comment letter or needs any additional information, please feel free to contact me at 212.508.6142, or my colleague, Bob Frenchman, at 212.508.6184.

Very truly yours,

Bracewell & Giuliani LLP



Julian Rainero

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