



February 20, 2015

Via Electronic Mail (pubcom@finra.org)

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 14-51: FINRA Request for Comment on Proposed Rules Requiring the Identification of Non-Member Broker-Dealers in Order Audit Trail System (OATS) Reports and the Reporting of Additional Order Information by Alternative Trading Systems (ATS)

Dear Ms. Asquith:

KCG Holdings, Inc. (KCG) respectfully submits this letter in response Regulatory Notice 14-51 (RN 14-51 or the Notice) issued by the Financial Industry Regulatory Authority (FINRA). KCG appreciates the opportunity to comment on the Notice and commends FINRA generally on its recent series of initiatives relating to market structure and automated trading activities.

RN 14-51 requests comment on proposed rule amendments that would require member firms to report additional information to OATS. The proposal has two primary components: (1) identification of non-member broker-dealers to OATS; and (2) reporting of additional order information by ATs. KCG supports FINRA's goal of improving its ability to support cross-market surveillance and monitor trading activity in the over-the-counter (OTC) market. However, as discussed in more detail below, we recommend that FINRA consider revising its proposal in several respects prior to filing it as a proposed rule change with the U.S. Securities and Exchange Commission (Commission).

I. Background

KCG is a global financial services firm that offers investors a range of services designed to address their trading needs across asset classes, product types and time



zones. As an independent, electronic market maker, KCG combines advanced technology with exceptional client service to deliver greater liquidity, lower transaction costs, improve pricing, and provide execution choices. KCG is a registered market maker on numerous U.S. cash equity and options exchanges, including a DMM and Supplemental Liquidity Provider on the New York Stock Exchange (NYSE), and a Lead Market Maker on NYSE Arca. As a market maker, KCG commits its capital to facilitate trades by buyers and sellers on exchanges, ATSS, and directly to our clients.

KCG offers clients multiple opportunities to interact with our market making operations. In addition, KCG's institutional clients have access to algorithms and experienced trading desks to access liquidity, maintain anonymity and minimize market impact. KCG also operates two Commission-registered ATSS.

II. Discussion

A. Identification of non-member broker-dealers to OATS

FINRA is proposing to require that a FINRA member (Reporting Member) that is reporting an order received from a non-member broker-dealer to identify the non-member broker-dealer as part of its OATS report. Currently, FINRA is able to identify with specificity the trading activity of FINRA member broker-dealers across market centers through the use of OATS reports and data provided to FINRA by the exchanges. FINRA is unable, however, to consistently identify the trading activity of non-member broker-dealers across market centers. Although Reporting Members do report to OATS orders they receive from non-member broker-dealers, these reports do not contain the identity of the non-member broker-dealer.

Under the proposal, a FINRA member receiving an order from a non-member broker-dealer would be required to reference a unique non-member identifier when reporting the order to OATS that would allow FINRA to identify the non-member broker-dealer. FINRA noted this identifier would either be an existing SRO-assigned identifier such as a market participant identifier (MPID) or the Central Registry Depository (CRD) number for non-member broker-dealer that does not have an SRO-assigned identifier. FINRA believes the inclusion of non-member broker-dealer



identities will significantly improve its ability to support cross-market surveillance and better monitor OTC trading activity.

KCG supports FINRA's proposal to better identify non-member trading activity across markets. We do, however, have several suggestions to improve the proposal. First, FINRA should compile a table (FINRA Table) that includes the preferred non-member identifier – whether an MPID, CRD, or some other identifier - to be relied upon by Reporting Members for identifying all non-member broker-dealers to OATS. FINRA should update the FINRA Table regularly and ensure it is readily available to all Reporting Members. Second, Reporting Members should only be required to report to OATS identifying information for non-member broker-dealers appearing on the FINRA Table. In other words, if a Reporting Member receives an order from a non-member broker-dealer that does not appear on the FINRA Table at the time of order receipt, the Reporting Member should not be required to provide any identifying information regarding the non-member broker-dealer to OATS. These revisions to the proposal will allow FINRA to perform appropriate cross-market surveillance while ensuring that Reporting Members identify non-members to FINRA in a consistent manner.

B. Reporting of additional order information by ATSS

FINRA is proposing to require ATSS that exceed a certain volume threshold¹ to report to FINRA through OATS 'additional order information' to supplement the order information ATSS currently report to OATS. FINRA noted that several data elements "are not required to be report to OATS, such as order re-pricing events (e.g., an order that is pegged to the National Best Bid or Offer) ... and [b]ecause these components of, or changes to, an ATSS order book are not reported, FINRA is not able to use existing OATS data to fully reconstruct an ATS order book for surveillance purposes." Under the proposal, an ATS would be required to report all events and order attributes that would change the ATS's system quantity (number of shares of an order, whether displayed or undisplayed, that can currently execute within the ATS), the displayed quantity, the highest (buy orders) or lowest (sell orders) price at which the order can currently execute within the ATS, and the displayed price for an order.

¹ The order reporting requirements would apply to any ATS that accounts for more than 0.25 percent of consolidated market share in any security over a one-month period.



One reason cited by FINRA in support of requiring additional information from ATSs is to allow FINRA to receive comparable information to the information it already receives from exchanges. While we applaud FINRA's efforts to better understand ATS operations, we believe this rationale reflects a fundamental misunderstanding about the meaningful differences between the operation of exchange matching engines and ATS matching engines. KCG believes that the proposal needs to be modified to recognize the real distinctions between exchanges and ATSs. Without such modifications, FINRA will be placing an undue burden on ATS operators to comply with a new requirement that provides FINRA with an enormous amount of supplemental data that will be of limited use towards FINRA's goal of reconstructing ATS order books for automated surveillance.

There are many examples of the differences between ATS and exchange operations, which are a result of markedly different business models and reflected in their respective matching engines. For example – unlike exchanges - ATSs do not necessarily re-price open orders with every movement in the market. While changes in the national best bid and offer (NBBO) impact the prices at which an ATS may potentially execute an order, these NBBO changes may not result in a re-pricing or other event. ATSs that do not display or route orders to other market centers may not re-price orders unless there is a contra-side order in the ATS, if at all. Also, an exchange must accept and execute all orders according to universal protocols based around price/time priority whereas an ATS may or may not use protocols based around price/time priority or may be designed to cater to certain preferences (order size, investor type, etc.). In addition, an ATS may allow for segmentation among subscribers, providing choice as to the types of counterparties with whom subscribers interact on the ATS based upon various categorizations (agency vs. principal; retail, institutional, electronic market maker; or based upon quantitative metrics such as liquidity profiles). As a result, ATSs may permit blocking and filtering among subscribers – such “opt-out” functionality is not permitted on exchanges – that may result in ATS orders that do not execute against what may appear to be otherwise available contra-side interest.

In addition to providing an incomplete view of ATS order books, KCG believes the proposal will manufacture a substantial number of additional new OATS records. On average, KCG currently generates and sends approximately 60 million OATS records



each day related to ATS activities. We estimate that implementation of the proposal will require us to generate and send anywhere from 15 to 30 times the amount of records we currently generate and send to OATS. Other ATS operators are also likely to face a similar surge in the volume of data they will need to generate and send to OATS. In addition, ATSs will also have to store this massive amount of new data to be generated by the additional records requirement. All of this will place a significant burden on ATS operators as they will be required to invest not only in substantial technology development time but also in ongoing hardware, storage and other infrastructure costs.

Currently, many ATS operators generate OATS reports by running an end-of-day batch process. The additional records requirement may necessitate that firms revamp their processes in order to meet their OATS reporting obligations. Specifically, the volume of new records that must be incorporated into ATS OATS workflows and may require the creation of real-time OATS generation process in order to meet this new requirement. The reason for the need to create real-time processes is largely due to existing time to process the overnight batch. Without significant modifications, batch processing times would likely exceed the requirements of delivery to FINRA by 8:00 AM on T+1, which will cause firms to experience breaks in OATS reporting.

KCG believes FINRA should meet with ATS operators and industry groups to discuss their operations with a view towards developing a standardized set of special handling codes to be used by ATS operators in OATS reports and which will account for opt-out features that result in otherwise executable contra-side orders not interacting.

* * *

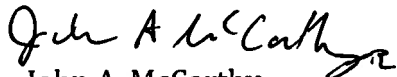
KCG recommends that FINRA consider our comments and suggestions and revise its proposal accordingly prior to filing it as a proposed rule change with the Commission.



III. Conclusion

KCG appreciates this opportunity to comment on FINRA Regulatory Notice 14-51. Please do not hesitate to contact me at 646-428-1615 if you have questions regarding any of the comments provided in this letter.

Sincerely,


John A. McCarthy
General Counsel

cc: Robert Colby, Chief Legal Officer, FINRA