



January 6, 2014

Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-0609

Re: File No. SR-FINRA-2013-036: Proposed Rule Change Relating to Wash Sale Transactions and FINRA Rule 5210 (Publications of Transactions and Quotations)

Dear Ms. Murphy:

The Futures Industry Association Principal Traders Group ("FIA PTG")<sup>1</sup> appreciates the opportunity to comment on the Financial Industry Regulatory Authority, Inc.'s ("FINRA") proposal to add supplementary material to FINRA Rule 5210 (Publication of Transactions and

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<sup>1</sup> FIA PTG is composed of firms that trade their own capital on the U.S. futures and equities exchange markets. FIA PTG members engage in manual, automated, and hybrid methods of trading, and are active in a variety of asset classes, such as foreign exchange, commodities, fixed income, and equities. FIA PTG member firms are direct participants on equities and options markets, and membership includes firms registered as broker-dealers, many of whom are registered as designated market makers on various national securities exchanges. FIA PTG member firms serve as a critical source of liquidity to U.S. markets, allowing those who use such markets, including individual investors, to manage their risks and invest effectively by allowing them to enter and exit markets efficiently.

Quotations) (“Proposal”).<sup>2</sup> The Proposal, as amended, would provide that securities transactions resulting from orders that originate from unrelated algorithms or separate and distinct trading strategies within the same firm would generally be considered bona fide transactions for purposes of Rule 5210. The Proposal would establish a presumption that algorithms or trading strategies within the most discrete unit of an effective system of internal controls are “related” and require FINRA members to have policies and procedures that are reasonably designed to review their trading activity for, and prevent, a pattern or practice of self-trades resulting from orders originating from a single or related algorithms or trading strategies.<sup>3</sup>

FIA PTG supports the changes in FINRA’s amendment to the Proposal and appreciates FINRA’s attempt to codify contemporary industry practice while taking into account the realities market participants face in trying to limit unintentional self-trades. First, we applaud FINRA’s determination to change the use of the term “wash sale” to “self-trade” as wash sales are generally understood to mean trades that are knowingly effected with manipulative intent, while self-trades, as described below, are those trades that can be both bona fide and inadvertent. Such determination recognizes the realities of automated trading in which independently initiated orders may coincidentally cross with each other in competitive markets.

Second, FIA PTG very much supports FINRA’s view that member firms have policies and procedures that are reasonably designed to review their trading activity for self-trades and prevent a pattern or practice of self-trades resulting from a single algorithm or trading desk or related algorithms or trading desks. In addition, we support the continued development by exchanges of functionality that will assist users in preventing self-trades.

Finally, despite its overall support for the Proposal, as amended, FIA PTG has some concerns about FINRA’s presumption of the relationship between algorithms or strategies within the most discrete unit(s) of a firm. In addition, we request that FINRA clarify firms’ obligation to review their trading activity for, and prevent, a pattern or practice of self-trades.

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<sup>2</sup> See Securities Exchange Act Release No. 70966 (Dec. 3, 2013), 78 FR 73900 (Dec. 9, 2013), at 73904 (Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove); Securities Exchange Act Release No. 70276 (Aug. 28, 2013), 78 FR 54502 (Sept. 4, 2013) (“Notice of Proposal”).

<sup>3</sup> Id.

## I. Discussion

FIA PTG believes that the Proposal, as amended, takes an important step in the right direction by recognizing that there is a substantial difference between “wash trades,” for which there is a fraudulent or manipulative purpose, and “self-trades,” which are inadvertent and are not engaged in for fraudulent or manipulative purposes. We appreciate FINRA’s acknowledgement in its response to comments that “[a]n individual transaction that is reported with a single firm on both sides of the trade is not per se illegitimate, and . . . that a failure to recognize this important point would impose a significant deterrent to legitimate trading activity.” FIA PTG agrees. These “self-trades” are the result of either –

- Buy and sell orders for accounts with common beneficial ownership that are independently initiated for legitimate and separate business purposes by independent decision makers and that coincidentally cross with each other in the competitive market; or
- Buy and sell orders submitted by the same trading desk or unit that match despite best efforts to avoid self-matching, due to the technical and operational limits of today’s matching engine technology. In most cases, exchange self-trade prevention tools prevent these types of self-trades.

Without the requisite fraudulent or manipulative intent, these types of trades are not “wash trades” and FINRA’s change in terminology is an important clarification of this point.

### A. Self-trades as bona fide transactions

FINRA Rule 5210 provides that no member may cause to be published or circulated any report of a securities transaction unless the member knows or has reason to believe that the transaction was a bona fide transaction. FINRA’s proposal is an attempt to clarify the types of self-trades that are bona fide transactions and the types of self-trades that are not. FIA PTG believes more clarity around this issue would be helpful to firms and enhance their ability to meet compliance expectations.

Although FINRA emphasizes that its focus is on self-trading between related algorithms, the text of proposed Supplementary Material .02 to FINRA Rule 5210 states that “[t]ransactions resulting from orders that originate from unrelated algorithms or separate and distinct trading strategies within the same firm would *generally* be considered bona fide self-trades” (emphasis added). FIA PTG seeks clarification on what factors and circumstances would cause trades

between unrelated algorithms or separate and distinct strategies *not* to be considered bona fide. Particularly concerning is FINRA's statement in a footnote to its Notice of Proposal that "transactions that originate from unrelated algorithms or from separate or distinct trading strategies, trading desks, or aggregation units that are frequent or numerous may raise a presumption that such transactions were undertaken with the intent that they cross and may, therefore, be intended as manipulative or fraudulent."<sup>4</sup> In light of FINRA's changes to the text of Supplementary Material .02 in Amendment No. 1, FIA PTG believes it is important that FINRA clarify its views about frequent or numerous self-trades between unrelated strategies. We believe that, when algorithms or trading strategies are otherwise unrelated, it would be inappropriate and inaccurate to infer their relatedness or the intent to self-trade based solely on a volume threshold.

As you are aware, many FIA PTG members conduct trading simultaneously in both the futures and securities markets. Members, therefore, encourage regulators to institute self-trading regulatory rules and interpretations that are consistent across both markets. FIA PTG notes that the Chicago Mercantile Exchange Group ("CME") recently updated its wash trading interpretation in which it recognized the realities of self-trading.<sup>5</sup> The CME Market Regulation Advisory Notice provides an excellent description of cases where self-matching is acceptable. The CME advisory notes: "[p]rovided that the respective orders of each independent trader are entered in good faith for the purpose of executing bona fide transactions, are entered without prearrangement, and are entered without the knowledge of the other trader's order, then such trades shall not be considered to violate the prohibition on wash trades." The CME applies the same interpretation to algorithms used under the stated conditions. FIA PTG suggests that FINRA consider taking the same approach as the CME to determine whether trades between unrelated algorithms are bona fide.<sup>6</sup>

The Commission states that it believes that questions remain as to whether FINRA's proposal is consistent with the requirements of Section 15A(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act"). In particular, the Commission states that "FINRA's proposal would appear to provide substantial flexibility with respect to the required policies and procedures, such that a significant number of self-trades could continue to be publicly reported," and that, therefore,

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<sup>4</sup> Notice of Proposal, *supra* note 2, at fn 5.

<sup>5</sup> CME Group Market Regulation Advisory Notice RA1308-5 issued on November 19, 2013 and found at: [http://www.cmegroup.com/tools-information/lookups/advisories/market-regulation/CMEGroup\\_RA1308-5.html](http://www.cmegroup.com/tools-information/lookups/advisories/market-regulation/CMEGroup_RA1308-5.html).

<sup>6</sup> For example, when the SEC adopted Regulation SHO, it provided the market with clear guidance on factors that could be used to verify the independence of a firm's aggregation units. See Securities Exchange Act Release No. 50103, footnote 25, available at: [http://www.sec.gov/rules/final/34-50103.htm#P107\\_26129](http://www.sec.gov/rules/final/34-50103.htm#P107_26129).

“the proposal may not achieve its stated purpose of addressing the identified problems associated with respect to self-trades. . . .”<sup>7</sup>

Section 15A(b)(6) of the Exchange Act requires the rules of a national securities association, such as FINRA, among other things, to be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest.<sup>8</sup> In 2009, the Commission found that FINRA’s Rule 5210 is consistent with the Exchange Act, including the requirements in Section 15(b)(6).<sup>9</sup> To approve FINRA’s Proposal, the Commission must find that the Proposal is consistent with the Exchange Act. The Commission is not required to find, as it implies it must, that the Proposal achieves FINRA’s stated purpose of addressing the identified problems associated with self-trades. Moreover, FIA PTG does not believe that FINRA has clearly established that there is a problem associated with self-trades and, therefore, it would be difficult, if required, for the Commission to find that the Proposal addressed such problem.<sup>10</sup>

#### **B. FINRA’s Proposed Presumption that Certain Trades are Non Bona Fide**

FIA PTG believes that FINRA’s amendment fails to clarify the standard that firms must meet in order for its trades to be considered bona fide transactions for purposes of Rule 5210. Multiple commenters noted that discrete units of a firm’s internal controls are established for reasons wholly separate from whether the trading strategies and algorithms within that unit are related. Nevertheless, FINRA’s amended proposal would continue to establish a rebuttable presumption that algorithms within those units are related.

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<sup>7</sup> Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove, supra note 3, at 73904.

<sup>8</sup> 15 U.S.C. 78o-3(b)(6).

<sup>9</sup> See Exchange Act Release No. 60835 (Oct. 16, 2009) (approving SR-FINRA-2009-055).

<sup>10</sup> In its original proposal, FINRA articulated the concern that self-trades “can create a misimpression of active trading in a security that could adversely impact the price discovery process.” However, FINRA did not provide support for this assertion with anything more than a statement that self-trades “can account for a material percentage (e.g., over 5%) of the consolidated trading volume in a security on a particular day.” Notice, supra note 3. FIA PTG believes further support is required to conclude that any of these self-trades are distortive or create any misimpression.

FIA PTG believes this presumption reflects a misunderstanding of what constitutes a separate trading strategy/algorithm and the degree to which trading strategies/algorithms within the same unit interact. FINRA responded to comments regarding this concern by stating “that there should continue to be a rebuttable presumption that algorithms within the most discrete unit of a firm’s internal controls are related,”<sup>11</sup> but fails to explain why this is necessary to further the purposes of its rule. As a result, FINRA’s Proposal, as amended, creates confusion over whether the presumption can be overcome and, if so, the standards that will be applied by FINRA to firms that attempt to overcome the presumption.

In its response to comments, FINRA states that it agrees that firms should be able to “attempt to demonstrate their compliance and rebut such a presumption.” However, in the same paragraph, FINRA states that it “believes it is unlikely that in such situations firms will be able to rebut the presumption that algorithms are ‘related.’” Further confusing this issue, FINRA continues by stating that it “clarifies that, notwithstanding a presumption that such algorithms are ‘related,’ firms are permitted to attempt to demonstrate that two or more algorithms within the most discrete unit of a firm’s internal controls, such as an aggregation unit, are not ‘related.’” FIA PTG strongly disagrees that this explanation in FINRA’s response to comments, which accompanies its amended Proposal, does anything to “clarify” the standards to which firms will be held.<sup>12</sup>

At a minimum, FINRA should provide clear guidance on factors that would rebut the presumption of relatedness. For example, when the SEC adopted Regulation SHO, it provided the market with clear guidance on factors that could be used to verify the independence of a firm’s aggregation units.<sup>13</sup> In this case, FIA PTG believes FINRA should amend its Proposal to recognize that relatedness could be rebutted by, for example, evidence that an algorithm/strategy operates as an independent decision maker as to when it should buy or sell a security or calculates profits and losses independent of other algorithms or strategies.

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<sup>11</sup> See Letter from Brant K. Brown, FINRA, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated December 2, 2013 (“FINRA December 2, 2013 Response Letter”) at p.5, available at: <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p398507.pdf>

<sup>12</sup> Id.

<sup>13</sup> See fn 6.

### C. Pattern or Practice

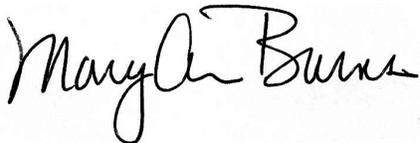
FINRA's proposal would require members to have policies and procedures reasonably designed to review their trading activity for, and prevent, a pattern or practice of self-trades resulting from orders originating from a single algorithm or trading desk, or related algorithms or trading desks. Because, as discussed above, there is a lack of clarity around how firms might rebut the presumption that algorithms or trading strategies within the most discrete unit of controls at a firm, such as an aggregation unit, are related, there is also a lack of clarity regarding the trading activities for which firms would need to review, and prevent, patterns or practices of self-trades. As suggested by other commenters previously, FIA PTG believes that it would improve firms' ability to comply with FINRA's rule if FINRA were more specific regarding the percentage of volume over repeated trading days that would constitute a "pattern or practice."

### II. Conclusion

FIA PTG would like to thank the Commission and FINRA for the opportunity to comment on the Proposal. We look forward to working with the Commission and FINRA to make further improvements to these requirements. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Mary Ann Burns ([maburns@futuresindustry.org](mailto:maburns@futuresindustry.org)).

Respectfully,

Futures Industry Association Principal Traders Group



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