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October 5, 2022

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549 - 1090

**Re: Exchange Act Release No. 30-95388; File No. S7-05-15. Exemption for Certain Exchange Members.**

The Security Traders Association[1] ("STA") appreciates the opportunity to provide comments in response to the Securities and Exchange Commission ("Commission") re-proposal of amendments to Rule 15b9-1 under the Securities Exchange Act of 1934 ("Act" or "Exchange Act") that exempts certain registered brokers or dealers from membership in a registered securities association ("Association"). The re-proposed amendments ("Proposal")[2] "would replace the rule's *de minimis* allowance, including the exclusion therefrom 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."

Since FINRA is the only SEC registered national securities association ("Association"), the Proposal would in effect, require certain proprietary trading firms to become FINRA members. For purposes of clarity, STA will refer to these firms as "non-FINRA members" or "non-member firms".

The Proposal raises transparency and oversight concerns in the equities and fixed income markets, and suggests that the current regulatory regime lacks important protections that result from an entity's registration and regulation under the Exchange Act. In addition, it implies that obligations and regulatory oversight that promote market stability and investor protection are not being consistently applied to entities engaged in similar activities. The Proposal asserts that a more robust regulatory regime is needed in equity and fixed income markets in the interests of investors.

STA will limit its views and recommendations to how the Proposal impacts non-members who engage in equity transactions.

**Summary Views and Recommendation**

STA recommends that the Commission not move forward with the Proposal. We believe that the Commission and FINRA are currently able to identify questionable cross-exchange and off-exchange

[1] STA is a trade organization founded in 1934 for individual professionals in the securities industry. STA is comprised of 24 affiliate organizations in North America with individual members who are engaged in the buying, selling and trading of securities. STA is committed to promoting goodwill and fostering high standards of integrity in accord with the Association's founding principle, Dictum Meum Pactum – "My Word is My Bond." For more information, visit https://securitytraders.org/.

[2] Exchange Act Release No. 30-95388; File No. S7-05-15. Exemption for Certain Exchange Members

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equity trading activity. Any improvements toward a more robust regime can and should be achieved within the current structure which grants an exemption to required FINRA membership.

**Remarks**

**Regulatory framework envisioned for Association.** The Proposal correctly states that Congress, under Section 15A of the Exchange Act, established the concept of and regulatory framework for, Associations to generally regulate broker-dealers' off-member-exchange securities trading activity. However, Congress expects the Commission to balance this concept with mandates under the Commission's three-part mission statement to protect investors, to maintain fair, orderly, and efficient markets, and to facilitate capital formation.

**The Proposal closely relates to the Commission's separate proposal in late March 2022 to significantly expand the scope of firms that must register as dealers (the Dealer-Trader Proposal).**[3] If both the Proposal and the Dealer-Trader Proposal are adopted, then the number of firms that would be required to register as dealers with the Commission and required to become FINRA members would exceed the estimated 65 firms that Commission estimates would be affected by the Proposal.

**The Proposal accurately describes the dramatic evolution of securities trading but fails to recognize advancements in essential ancillary functions to trading such as compliance, risk monitoring, market data, trade processing, and analytics.** Equity markets have evolved from being primarily floor-based to becoming mostly electronic with registered dealers engaging in significant amounts of cross-market proprietary trading. This evolution - which has been driven primarily by technological advancements - is not limited to just the trading of securities. There have been dramatic improvements in the capabilities of non-member firms to perform essential non-trading functions in such areas as trade processing and risk mitigation. The Proposal fails to recognize these advancements, which should be considered by the Commission before non-members are burdened with additional regulatory costs. Failing to do so raises questions about whether additional market stability can be achieved with having these firms subject to FINRA membership.

**There has also been a dramatic evolution in the capabilities of regulators to monitor cross-market trading between listed options and equities that is initiated cross-exchange and off-exchange.** The introduction of the Consolidated Audit Trail, ("CAT")[4] has greatly increased the amount of quantitative and qualitative data available to the Commission on equity and options trading. STA has supported the Commission's ability to have such a regulatory tool which requires all market participants, including non-FINRA member firms, to report their trading activity.

CAT has greatly improved the ability of regulators to identify nefarious activity, in particular that which is initiated cross-exchange and off-exchange, and across the equity and options markets. Importantly, non-member firms are subject to the same CAT reporting requirements on equity and options trading as FINRA member firms. While CAT has not yet been fully implemented, its current functionality provides the Commission and FINRA with a robust monitoring tool that we believe enables regulators to identify

[3] U.S. Securities and Exchange Commission, Proposed Rule, Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer, Release No. 34-94524, File No. S7-12-22 (Mar. 28, 2022), available at https://www.sec.gov/rules/proposed/2022/34-94524.pdf.
[4] Consolidated Audit Trail; www.catnmsplan.com

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complex and questionable behaviors. The effectiveness of CAT can be observed in the Proposal by the numerous times it is referred to as the source of a meaningful data point.

Additionally, non-member firms who do not have customers are regulated by the Commission and at least one Self-Regulatory Organization ("SRO") of an exchange of which they are a member. In addition, they must also abide by anti-manipulation and anti-fraud provisions under Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act. The Proposal does not clearly state what additional trade reporting information, if any, would become known to the Commission from non-member firms who became FINRA members.

**The Proposal is blunt and over-sweeping in that it captures a large number of non-member firms with *de minimis* or no cross-exchange and off-exchange trading.** The Commission states that of the estimated sixty-five (65) broker-dealers that were exchange members but not FINRA members as of April 2022, twenty-two (22) did not initiate orders in listed equities off-exchange in that month. In addition, the Commission acknowledges that there is a high concentration of off-exchange trading activity among the residual subset of the non-member firms who did initiate off-exchange orders. As an example, the Commission states that in September 2021, forty-seven (47) firms initiated off-exchange activity with thirteen (13) of them accounting for 94% of all activity.

These figures support STA's view that the Proposal is too broad in application because it captures firms with little to no off-exchange activity and subjects them to unnecessary oversight and regulation. STA understands the benefits and efficiencies which can be achieved through a uniform regulatory reporting regime. However, we believe the Proposal is over-reaching and is a one-size-fits-all regulation that if enacted will lead to negative consequences for most existing non-member firms.

**The Proposal fails to articulate where the current regulatory regime fails to protect investors.** There are no examples provided of patterns of nefarious behavior by bad actors that went unnoticed due to some deficiency within the current regime. Nor are there examples of nefarious behaviors identified by FINRA that went unpunished due to flaws within the existing reporting regime that is primarily built upon coordinated regulatory arrangements with those SROs responsible for regulatory oversight of non-members. Rather, the Proposal's justification for a more robust regulatory regime is due to the increased amount of cross-exchange and off-exchange trading in the equity markets. While STA agrees with the observation that the amounts of cross-exchange and off-exchange has increased, we do not believe it is a reason on its own to justify this significant regulatory course of action.

**The Proposal would have a disproportionately negative impact on certain options market making firms and liquidity providers by subjecting them to rule sets that are unrelated to their business.** A contributing factor to overall efficiencies which exist in our markets is the ability for capital to flow between the equity and options marketplaces with limited friction. Option market makers and liquidity providers facilitate this function. This results in additional liquidity for both marketplaces and assures prices for options and their underlining securities remain aligned, thus dampening volatility.

In STA's June 19, 2015, letter[5] to FINRA we expressed our view that the cost of entry to liquidity providers (market makers and proprietary trading firms) in the options markets was so high that any exit of an existing participant would be permanent. Our statement proved to be prophetic as the number of non-

[5] June 19, 2015 STA letter to Marcia E. Asquith, Office of the Corporate Secretary, FINRA Re: FINRA Regulatory Notice 15 – 13; Proposed Exemptions to the Trading Activity Fee ("TAF") for Proprietary Trading Firms

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member firms in 2015 were eight-five (85) and today, according to the Proposal, that figure is roughly sixty-five (65). While some of those firms may have chosen to become FINRA members or have been acquired, we believe the vast majority have closed.

It was our view then and remains today that regulators need to be cautious on imposing unnecessary costs on this segment of the marketplace. There are meaningful explicit costs with being a FINRA member. Explicit costs include initial membership application, continuing membership applications, registration and examination fees, gross income assessment fees and ongoing examination and reporting requirements. FINRA's Trading Activity Fee ("TAF"), if left in its current state, would be another example of a meaningful explicit cost.

**Conclusion**

STA believes that Proposal is overly sweeping and would increase regulatory costs without providing a corresponding improvement in regulatory quality. We believe the Proposal will negatively impact liquidity, volatility, and capital formation. We recommend that Commission not proceed with its implementation but instead pursue a less burdensome approach working within the current regime.

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