

FINANCIAL INFORMATION FORUM

5 Hanover Square
New York, New York 10004

212-422-8568

Via Electronic Delivery

October 31, 2013

Elizabeth M. Murphy
Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. SR-FINRA-2013-039 - Notice of Filing of Proposed Rule Change to Clarify the Classification and Reporting of Certain Securities to FINRA

Dear Ms. Murphy,

The Financial Information Forum (FIF)¹ would like to take this opportunity to provide comments on SR-FINRA-2013-039 - Notice of Filing of Proposed Rule Change to Clarify the Classification and Reporting of Certain Securities to FINRA, (“the Proposal”). FIF members are concerned that the Proposal will incur a significant technology burden which may not be justified by the benefits and recommend modifying the proposal to clarify that TRACE is the appropriate reporting facility for both depositary shares and capital trust securities (“identified hybrid securities”). We believe this is justified based on the following reasons:

1. Accommodating equity trade and OATS reporting would disrupt fixed income trading workflows
2. Downstream impacts require clarity and further analysis
3. Implementation and ongoing costs may not justify benefits

Accommodating equity trade and OATS reporting would disrupt fixed income trading workflows

Currently, the identified hybrid securities are traded as fixed income securities. It is important to recognize that most firms have a bifurcated trading, operations and technology architecture for equities and fixed income that is designed to manage the complete order lifecycle from order entry through settlement including market data and trade reporting.

¹ FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the financial technology industry across the order lifecycle. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

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We are concerned about the impact of disrupting this flow to accommodate trade reporting into the OTC Reporting Facility (ORF). In addition to altering technology and operations processes, traders would need to be trained and learn to manage both fixed income and equity order management systems. Technology to bridge the two architectures for the purpose of trade reporting and position monitoring would be required.

It is important to recognize that many of these trades are negotiated manually. While we understand that FINRA will take into consideration the complexity and manual nature of the execution and reporting of the trade when reviewing for firm compliance with the new 10 second trade reporting time frame, the shift from the TRACE obligation of 15 minute reporting to the ORF obligation of 10 second reporting timeframe will have implementation implications.

Additionally, market data modifications would be required in order to appropriately classify depository shares as ORF-eligible securities even though they will trade as fixed income instruments for clearance and settlement purposes. It is important to note that today CUSIPs are assigned into either a debt or equity range. Additionally, pricing vendors rely on these classifications to accurately price the security using either fixed income or equity based valuation methodologies. Over-riding vendor-provided prices may be required in order to ensure accurate pricing.

FIF members are particularly concerned about the OATS reporting implications of the Proposal, given that OTC equities reported to ORF are OATS eligible. Most firms have no manual reporting into their OATS process as it is a highly automated process entrenched in the equities workflow. The systems that trade depository shares do not currently incorporate concepts like order routing and time stamping to the degree required by OATS. Building this functionality into fixed income systems or transferring data on depository shares to equity order management systems represents functionality that does not exist today and is not part of the design of either group of systems. Multiple proprietary and vendor systems would be involved in accommodating OATS processing for these newly identified OTC equity securities.

Downstream Impacts Require Further Clarity and Analysis

The Proposal does not discuss downstream impacts as a result of classifying depository shares as OTC equity securities. It is unclear the extent to which reclassifying depository shares as OTC equity securities impacts their classification for other purposes. Before approving the Proposal, we request additional information and the opportunity to comment on the downstream impacts of this proposal to the following.

- **Section 31 Fees:** Footnote 13 of the Proposal states that, “If the transaction is reported to the ORF, the transaction is treated as one involving an equity security and is subject to the regulatory transaction fee.” In order to manage the Section 31 payment process, firms often accrue fees to pay for what FINRA charges them. If depository shares are being booked as bonds, firms will have to develop alternate means of accruing these charges. It is important to recognize that if these charges are passed back to clients, changes will also be required to 10b-

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10 confirms. Even if alternate means of assessing the Section 31 fees was identified the development effort to alter confirms would remain.

- TAF Fees: While fixed income products are included in TAF, there is a different formula that applies to the calculation of equities.
- Electronic Blue Sheets (EBS): EBS records are typically based on cleared activity. It is unclear whether reporting based on equity fields or fixed income fields would be required.
- INSITE Reporting: It is unclear if depository shares should be classified as debt or non-exchange listed equity transactions for the purposes of INSITE reporting.
- Short Interest: Even if a firm's books and records have depository shares booked as bonds, these securities may need to be incorporated into short interest calculations. The impact on net capital to meet haircut requirements would need to be assessed.
- Beneficial Ownership: May not be captured if security is booked as a bond
- Order Ticket: Equity and bond order tickets have different characteristics and data fields. It is unclear the extent to which order tickets will need to be altered as a result of this classification
- Confirms: Confirm disclosure rules differ between equities and fixed income. It is unclear the extent to which confirms will be required to change. As discussed earlier, a link will need to be established if regulatory fees are assessed.
- Corporate actions: It is unclear if corporate actions would now be classified as dividends as opposed to interest. Currently, vendors will classify as interest any corporate action on a debt-classified CUSIP.
- Tax Treatment: It is unclear the extent to which tax treatment of depository shares changes as a result of trade reporting classification as an OTC Equity Security.

Additional analysis would be required to determine the impact on other downstream functions including best execution and statements.

Implementation and Ongoing Costs May Not Justify Benefits

As described above, significant changes would be required in order to continue trading depository shares as fixed income securities. Additionally, trading these securities as equities also poses a number of technical and process challenges. Given that the SIFMA survey described in their comment letter² indicates that depository shares represent only 7% of hybrid securities, FIF questions whether the benefits of this proposal outweigh the costs.


² See October 21, 2013, [SIFMA Comment Letter on SR-FINRA-2013-039 from Sean Davy, Managing Director, Capital Markets, SIFMA](#)

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An alternate means of reducing investor confusion and providing clarity would be to identify depositary shares as fixed income, TRACE-eligible securities. Such an approach would provide clarity while being consistent with current trading and technology practices. Additionally, investors may actually prefer fixed income confirms given the additional detail provided on those disclosures.

We understand the need for clarity with respect to depositary shares and other hybrid securities but would recommend interpretative guidance that clarified that the identified hybrid securities are both TRACE-eligible. Prior to approving the Proposal, additional information is required to understand and evaluate the downstream implications. While we recognize that the current Proposal applies only to depositary shares and capital trust securities, we believe the impact of this Proposal is far-reaching and the costs should be carefully considered.

Regards,

A handwritten signature in black ink that reads "Manisha Kimmel". The signature is written in a cursive, flowing style.

Manisha Kimmel
Executive Director
Financial Information Forum