

# Section 31 Fee Reconciliation Process

FIF Member Presentation to FINRA on Enhancing the Reconciliation  
Process for the FINRA Regulatory Transaction Fee (for Recoupment of  
Section 31 Fees)

# Overview

# Current challenges

- Clearing brokers that receive Regulatory Transaction Fee (RTF) invoices from FINRA do not have sufficient detail to reconcile these invoices against their trading activity and the trading activity of their correspondent firms
  - The single line item from FINRA indicating the total charge does not provide sufficient detail for reconciliation
- Executing brokers that are charged RTF pass-through fees by their clearing brokers are not able to reconcile those charges against their trading activity
  - Executing brokers receive no statements from FINRA, and FINRA does not break-out the charges to the clearing firm based on the executing broker
- Originating brokers (and their clearing firms) that are charged RTF pass-through fees by downstream intermediary brokers are not able to reconcile those charges against their trading activity

## Current challenges (continued)

- Broker-dealers often collect funds from customers for trades where they are not billed by FINRA or a downstream broker-dealer, and there is a lack of available data for broker-dealers on what to do with these funds
- Due to inability to reconcile, there is often lack of clarity among broker-dealers as to when a fee should be passed through
- Firms must expend significant resources to attempt reconciliation without the necessary underlying data

# FIF member request

- FIF members request that FINRA provide a monthly file to each clearing firm and executing firm identifying each execution where the firm is charged the Regulation Transaction Fee (RTF) and the amount charged per execution
- FIF members request a call with FINRA representatives to discuss this request
- In this presentation below, we also discuss potential alternative approaches for consideration by FINRA that seek to achieve the same objective of enabling proper reconciliation of RTF fees
  - FIF members do not necessarily recommend these alternative approaches but believe it is helpful to consider these potential alternative approaches

# Objectives that FIF members seek to achieve

- Best practice for broker-dealer financial responsibility is reconciliation of material expenses
- Enable broker-dealers to properly reconcile RTF fees
- Significantly reduce (and potentially eliminate) the scenarios where a broker-dealer collects Section 31 fees from a customer and is not billed by FINRA or a downstream broker-dealer
- Ensure that the correct broker-dealer incurs the RTF for a trade
- Facilitate straight-through processing for the collection of RTF fees

# The CAT Plan Participants plan to provide this data for CAT

- In a [filing with the SEC on July 28, 2023](#), the CAT Operating Committee wrote
  - “The Plan Processor is building a billing warehouse that will contain every trade, and plans to make available trade-by-trade data to CAT Executing Brokers for each CAT bill upon request. Such data may assist CAT Executing Brokers with identifying and validating the applicable trades for each CAT bill.”
- In a [September 28, 2023 webinar on CAT billing](#), FINRA CAT reported that underlying trade details for all trades invoiced will be available to CAT Executing Brokers via SFTP and the CAT Reporter Portal (see Slide 43 of the September 28 presentation)
- FIF members request that FINRA provide this same type of data when invoicing the Regulatory Transaction Fee

# Notes for Scenarios

## Notes for scenarios: Section 31 fees

- Technically, the Section 31 fee is charged by the SEC to FINRA, and FINRA charges a Regulatory Transaction Fee (RTF) to the clearing firm for the seller
- Clearing firms and other industry members can then pass this fee through to correspondents, upstream routing brokers and customers
- While these pass-throughs are not technically Section 31 fees (only the fee from the exchange to the SEC is a Section 31 fee), we refer to these pass-throughs as Section 31 fees because this is how the industry often refers to them

# Notes for scenarios: the parties

- MMZZ: the buying broker-dealer
- MMXY: the intermediary broker-dealer
- CBXY: the clearing firm for MMXY
- RBRB: broker-dealer that routes order to MMXY or MMZZ
- CBCB: the clearing firm for RBRB
- Customer: a customer of RBRB

# Notes for scenarios: four scenarios

- Scenario 1: Two broker-dealers
- Scenarios 2 through 4: Three broker-dealers
  - Scenario 2: Intermediary broker-dealer trades as riskless principal
  - Scenario 3: Intermediary broker-dealer trades as agent
  - Scenario 4: Intermediary broker-dealer trades as principal

## Notes for scenarios: party roles

- Scenarios 1 through 4 provide for a market maker as the executing party, but the executing party could be any firm that trades as principal
- Scenarios 2 through 4 provide for a market maker as the intermediary, but the intermediary could be a firm (trading as principal, riskless principal or agent) that is not a market maker
  - For example, the intermediary could be a routing firm that only trades as agent

# Notes for scenarios: fees to customers

- In the scenarios presented the originating broker-dealer (RBRB) acts on behalf of a customer, but RBRB also could be trading as principal
- The diagrams describe CBCB, the clearing firm for RBRB, as extracting fees from an RBRB customer account
  - If RBRB trades as principal, the clearing firm for RBRB would extract fees from an RBRB principal account

## Notes for scenarios: executing broker

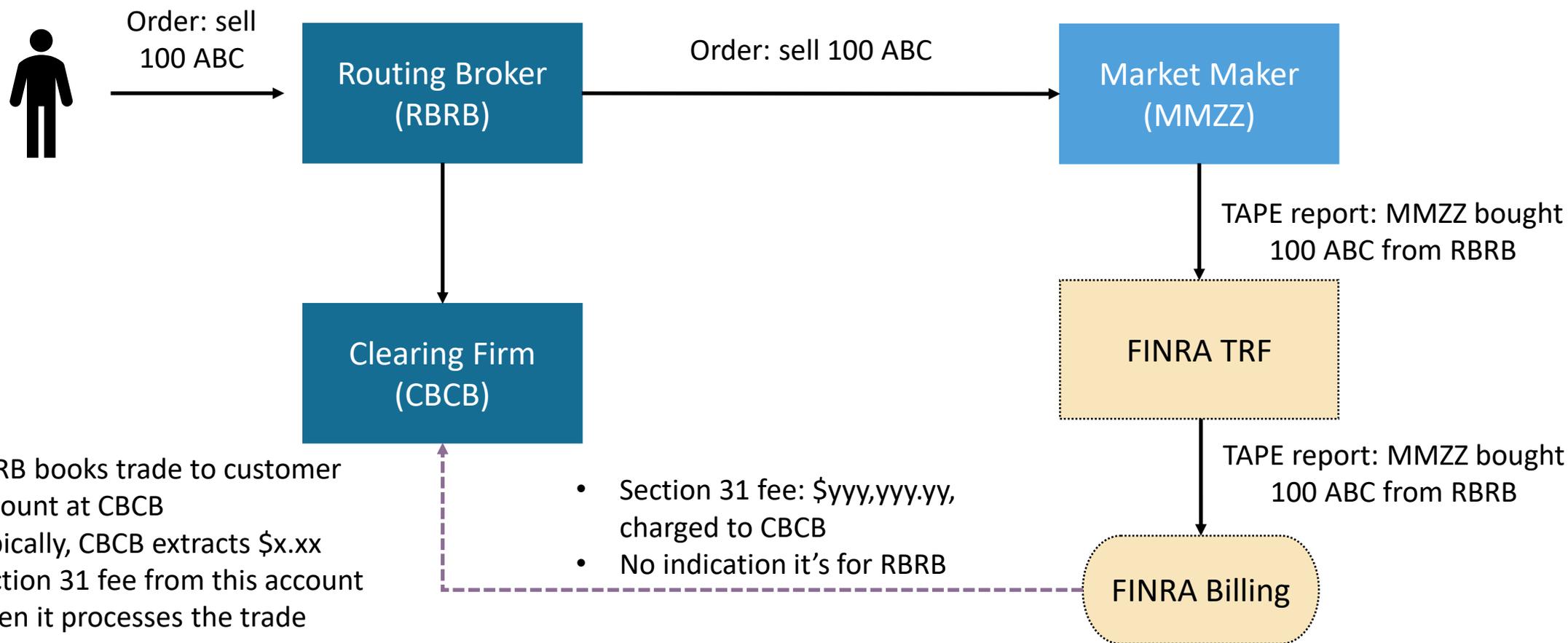
- In this presentation, when we refer to the “executing broker”, we are referring to the correspondent firm of the clearing firm that is being charged for the trade
- This correspondent firm is identified by the reporting firm in the TRF report and might be the “order entry” or “OE” firm (i.e., the contra to the executing broker) rather than the executing broker
- In other words, for TRF reporting only one side is the “executing broker” while in this presentation both sides are the executing broker (similar to CAT billing terminology)

# Notes for scenarios: additional scenarios

- This document covers four basic scenarios
- These scenarios are intended to be illustrative and are not intended to address all trading and settlement workflows
- More complex scenarios can be considered after there is consensus on the four scenarios in this document
- This document is focused on equity trades that are executed off-exchange and reported to a FINRA TRF or the ORF; a similar approach should be implemented for exchange-traded executions for both equities and options
  - After discussion with FINRA representatives, FIF members also plan to discuss this request with exchange representatives

# Scenarios

# Scenario 1: Execution Between Two Broker-Dealers



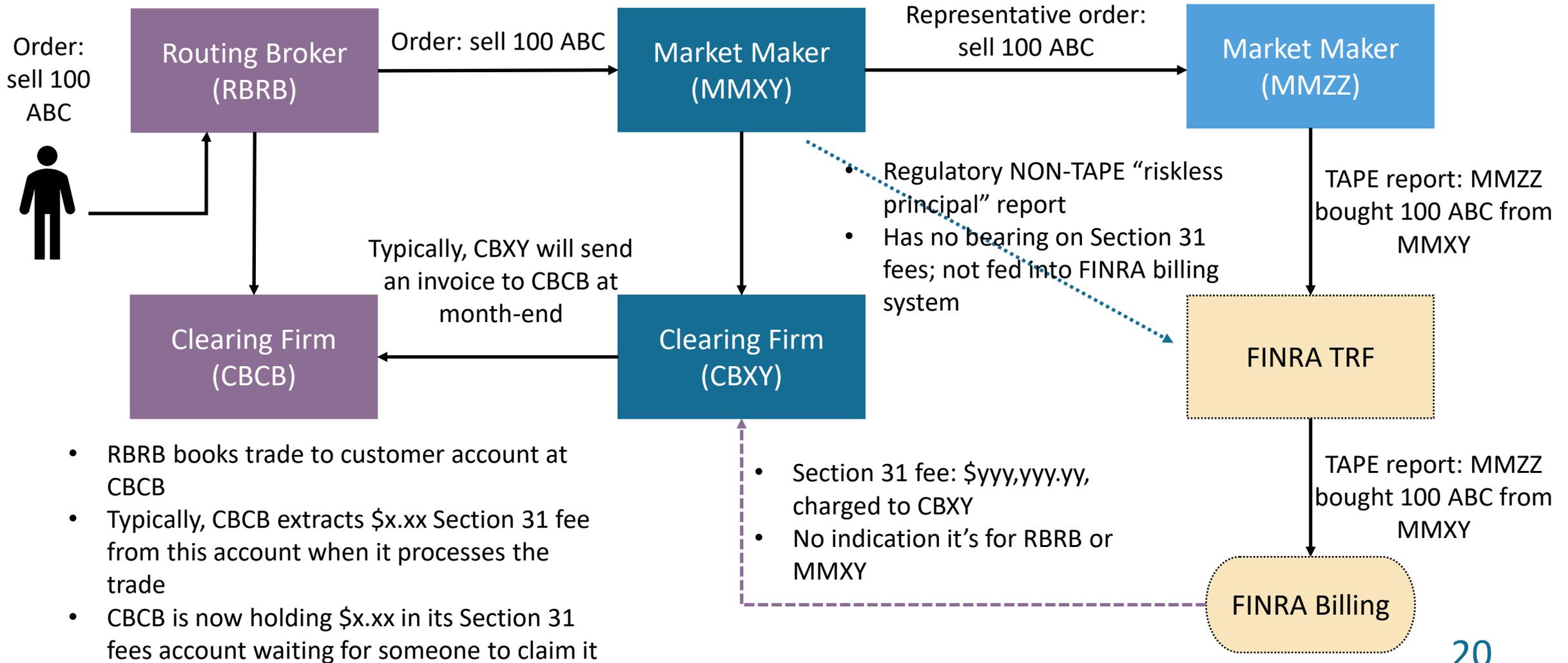
# Scenario 1: Execution Between Two Broker-Dealers

Execution Between Two Broker-Dealers	
<b>Trading Scenario</b>	RBRB routes sell order to MMZZ; MMZZ executes as principal against RBRB
<b>TRF Reporting</b>	MMZZ submits a tape report to FINRA
<b>Regulatory Transaction Fee</b>	FINRA charges the Regulatory Transaction Fee to CBCB (clearing firm for RBRB)
<b>Pass-Through</b>	Not required in this scenario

# Scenario 1: Execution Between Two Broker-Dealers

Execution Between Two Broker-Dealers	
<b>Potential Challenges</b>	<ul style="list-style-type: none"> <li>• How does CBCB validate whether it was correctly billed for this trade by FINRA (for example, how does CBCB identify the cause of a mismatch)?</li> <li>• How does CBCB reconcile what it charges to RBRB against the bill from FINRA?</li> <li>• How does RBRB reconcile what it is charged by CBCB?</li> </ul>
<b>Industry Processes</b>	<ul style="list-style-type: none"> <li>• Pass-through of Regulatory Transaction Fee does not apply</li> </ul>
<b>Request for FINRA</b>	<ul style="list-style-type: none"> <li>• FINRA should provide a monthly file to each clearing firm and executing firm identifying each execution where it is charged</li> <li>• This would allow CBCB and RBRB to validate that they are being billed correctly</li> </ul>

# Scenario 2: Intermediary Trades as Riskless Principal



- RBRB books trade to customer account at CBCB
- Typically, CBCB extracts \$x.xx Section 31 fee from this account when it processes the trade
- CBCB is now holding \$x.xx in its Section 31 fees account waiting for someone to claim it

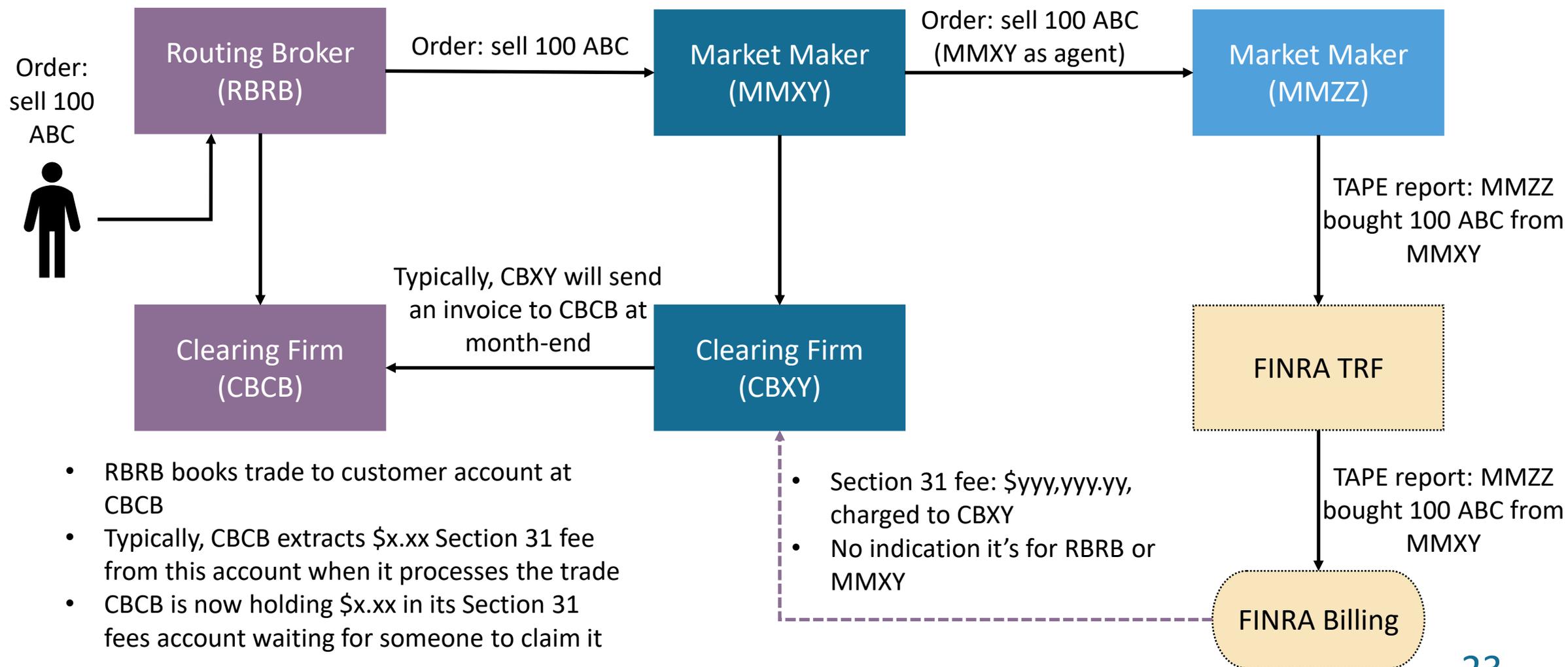
## Scenario 2: Intermediary Trades as Riskless Principal

Intermediary Trades as Riskless Principal	
<b>Trading Scenario</b>	RBRB routes sell order to MMXY; MMXY creates representative order and routes to MMZZ; MMZZ executes against MMXY; MMXY executes as riskless principal against RBRB
<b>TRF Reporting</b>	MMZZ submits a tape report to FINRA; MMXY submits a non-tape riskless principal report to FINRA
<b>Regulatory Transaction Fee</b>	FINRA charges the Regulatory Transaction Fee to CBXY (clearing firm for the selling broker-dealer)
<b>Pass-Through</b>	CBCB extracts \$x.xx from RBRB when CBCB processes the trade; CBCB is now holding \$x.xx in its Section 31 Fees Account, waiting for someone to claim it; typically, MMXY will send an invoice to RBRB/CBCB at month-end

## Scenario 2: Intermediary Trades as Riskless Principal

Intermediary Trades as Riskless Principal	
<b>Potential Challenges</b>	<ul style="list-style-type: none"> <li>• See Scenario 1 challenges</li> <li>• How does CBXY know to invoice CBCB? CBXY can only know to bill CBCB if CBXY knows that MMXY traded as riskless principal</li> <li>• How does CBCB validate the invoice from CBXY?</li> <li>• How does CBCB reconcile the invoice from CBXY to a trade for RBRB?</li> </ul>
<b>Industry Processes</b>	<ul style="list-style-type: none"> <li>• MMXY can communicate to CBXY that MMXY is acting as riskless principal and identify RBRB and CBCB</li> <li>• CBXY can provide this information to CBCB when invoicing</li> </ul>
<b>Request for FINRA</b>	<ul style="list-style-type: none"> <li>• FIF members request that FINRA provide a monthly file to each clearing firm and executing firm identifying each execution where it is charged</li> <li>• This would allow MMXY and CBXY to demonstrate to CBCB that FINRA charged them for a trade</li> <li>• This would allow CBCB to identify the trades where it has already been charged by FINRA and avoid getting billed twice for the same trade</li> </ul>

# Scenario 3: Intermediary Trades as Agent



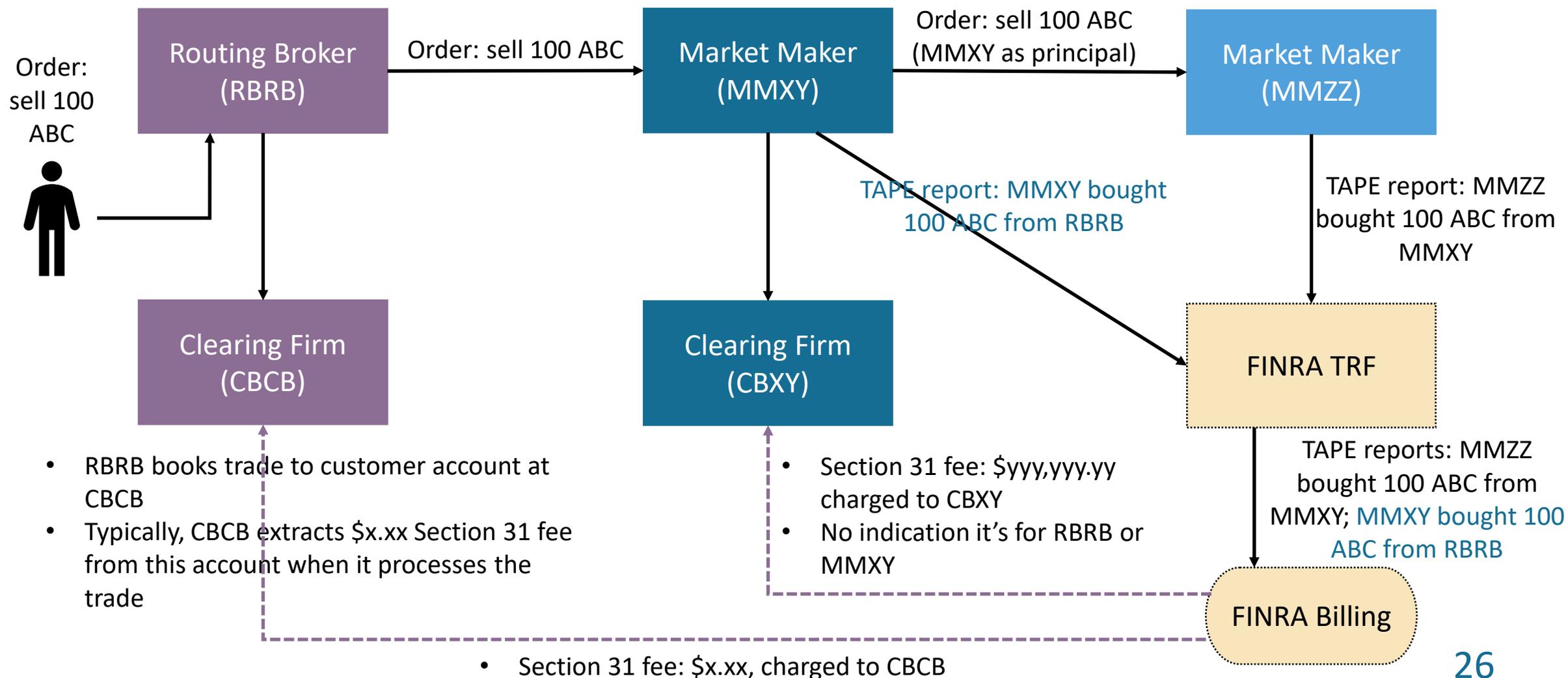
## Scenario 3: Intermediary Trades as Agent

Intermediary Trades as Agent	
<b>Trading Scenario</b>	RBRB routes sell order to MMXY; MMXY routes RBRB order to MMZZ; MMZZ executes against MMXY
<b>TRF Reporting</b>	MMZZ submits a tape report to FINRA
<b>Regulatory Transaction Fee</b>	FINRA charges the Regulatory Transaction Fee to CBXY (clearing firm for the selling broker-dealer)
<b>Pass-Through</b>	CBCB extracts \$x.xx from RBRB when CBCB processes the trade; CBCB is now holding \$x.xx in its Section 31 Fees Account, waiting for someone to claim it; typically, MMXY will send an invoice to RBRB/CBCB at month-end

## Scenario 3: Intermediary Trades as Agent

Intermediary Trades as Agent	
<b>Potential Challenges</b>	<ul style="list-style-type: none"> <li>• See Scenario 1 challenges</li> <li>• How does CBXY know to invoice CBCB? CBXY can only know to bill CBCB if CBXY knows that MMXY traded as agent</li> <li>• How does CBCB validate the invoice from CBXY?</li> <li>• How does CBCB reconcile the invoice from CBXY to a trade for RBRB?</li> </ul>
<b>Industry Processes</b>	<ul style="list-style-type: none"> <li>• MMXY can communicate to CBXY that MMXY is acting as agent and identify RBRB and CBCB</li> <li>• CBXY can provide this information to CBCB when invoicing</li> </ul>
<b>Request for FINRA</b>	<ul style="list-style-type: none"> <li>• FINRA should provide a monthly file to each clearing firm and executing firm identifying each execution where it is charged</li> <li>• This would allow MMXY and CBXY to demonstrate to CBCB that FINRA charged them for a trade</li> <li>• This would allow CBCB to identify the trades where it has already been charged by FINRA and avoid getting billed twice for the same trade</li> </ul>

# Scenario 4: Intermediary Trades as Principal



## Scenario 4: Intermediary Trades as Principal

Intermediary Trades as Principal	
<b>Trading Scenario</b>	RBRB routes sell order to MMXY; MMXY routes principal order to MMZZ; MMZZ executes against MMXY; MMXY executes as principal against RBRB
<b>TRF Reporting</b>	MMZZ submits a tape report to FINRA; MMXY submits a tape report to FINRA
<b>Regulatory Transaction Fee</b>	For the first trade, FINRA charges the Regulatory Transaction Fee to CBXY (clearing firm for MMXY); for the second trade, FINRA charges the Regulatory Transaction Fee to CBCB (clearing firm for RBRB)
<b>Pass-Through</b>	Not required in this scenario

## Scenario 4: Intermediary Trades as Principal

Intermediary Trades as Principal	
<b>Potential Challenges</b>	<ul style="list-style-type: none"> <li>• See Scenario 1 challenges</li> <li>• How does CBCB validate that it is not being double-billed for this trade?</li> </ul>
<b>Industry Processes</b>	<ul style="list-style-type: none"> <li>• MMXY can communicate to CBXY that MMXY is acting as principal</li> <li>• CBXY can charge MMXY for this trade (the sale by MMXY)</li> </ul>
<b>Request for FINRA</b>	<ul style="list-style-type: none"> <li>• FINRA should provide a monthly file to each clearing firm and executing firm identifying each execution where it is charged</li> <li>• This would allow CBCB to validate that it is not being double-billed by other clearing firms</li> </ul>

# Request for FINRA

# Request for FINRA to provide monthly file

- FIF members request that FINRA provide a monthly file to each clearing firm and executing firm identifying each execution where the firm is charged the RTF and the amount charged per execution
- This would enable all parties to reconcile what they are being charged (either directly by FINRA or by another broker-dealer) against what they should be paying
- This would also enable an intermediary broker-dealer, for scenarios where the intermediary broker-dealer acts as riskless principal or agent, to provide back-up to the originating broker in support of the pass-through of the fee from FINRA

# Request for FINRA to provide monthly file

- The following issues would need to be considered
  - What level of detail should be provided for each trade
  - Execution identifiers that firms could use for reconciliation
  - Given the potential size of execution files, whether the report could aggregate individual trades and whether this aggregation would enable reconciliation
  - The method for transmission of these files by FINRA

# Potential Alternative Approaches

## Alternative 1: database of RTF charges

- In lieu of providing monthly files, FINRA could maintain a database that executing and clearing firms could query
- Each firm would only be permissioned to query a trade where it is being charged the RTF
- For this alternative, security issues would need to be addressed

## Alternative 2: identify executing brokers on invoices

- If FINRA is not able to provide trade-by-trade data, FINRA could break-out invoices to clearing firms based on the executing broker (i.e., broken out by MPID)
  - The exchanges currently provide this break-out (by MPID) to clearing firms upon request
- While break-out by MPID would be an improvement over the current level of detail provided by FINRA, trade-by-trade detail most likely would be required to achieve the reconciliation objectives set forth in the Overview of this presentation

## Alternative 3: bill originating broker directly

- FINRA could use CAT data to bill the originating broker directly
- This presumably would require FINRA to change its by-laws
- Potential challenges with using CAT data for this purpose
  - FINRA would need to consider how to avoid double billing for riskless principal scenarios
  - FINRA would need to satisfy itself that industry members are reporting activity correctly to CAT

## Alternative 4: reconsider RTF collection process

- FINRA could consider alternative approaches for collecting the Regulatory Transaction Fee (RTF), such as the approach used for collecting the Trading Activity Fee (TAF)

Contact [fifinfo@fif.com](mailto:fifinfo@fif.com) with  
comments or questions