

CLIENT ALERT

FINRA Proposes Enhanced IDQS Requirements

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Coming close on the heels of adoption by the Securities and Exchange Commission (“SEC”) of substantial amendments to Rule 15c2-11 governing over-the-counter (“OTC”) quotations for securities,¹ the Financial Industry Regulatory Authority (“FINRA”) has proposed to adopt new Rule 6439 “to expand and enhance the obligations of [FINRA] member firms that operate certain systems that regularly disseminate the quotations of identified broker-dealers in OTC Equity Securities” (“interdealer quotation system” or “IDQS”).²

FINRA notes that, although it currently has in place extensive rules that govern the activities of FINRA firms that display quotations on IDQs, the rules generally do not provide governance standards for the IDQs themselves. FINRA believes that imposing certain requirements on IDQs would benefit investors and be consistent with FINRA’s obligations under Sections 15A and 17B of the Securities Exchange Act of 1934.³

Among other things, proposed Rule 6439 would apply aspects of SEC Regulations ATS and SCI to IDQs irrespective of whether they are subject to those regulations. Specifically:

- Certain provisions would apply to all IDQs:⁴
 - Quotation display. Paragraph (a) would require an IDQS to establish, maintain, and enforce written policies and procedures (“P&P”) relating to the collection and dissemination of quotation information, including the methodology and factors relevant for ranking and displaying quotations. The P&P must be prominently disclosed to

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¹ Please see our Client Alert about the Rule 15c2-11 changes: https://www.mmlawus.com/newsitem/pdf/Rule_15c2-11_amendments_memo_09282020_2662387465613786115.pdf.

² Release 34-90067 (October 1, 2020), 85 FR 63314 (October 7, 2020), <https://www.govinfo.gov/content/pkg/FR-2020-10-07/pdf/2020-22097.pdf>. IDQS is defined identically in Rule 15c2-11 and for purposes of FINRA’s rules as “any system of general circulation to brokers or dealers which regularly disseminates quotations of identified brokers or dealers.” FINRA states that “all quotation activity in OTC Equity Securities occurs on member-operated inter-dealer quotation systems.” Id. at 63316.

³ FINRA noted that it had previously proposed (and subsequently withdrew) rule amendments substantially similar to some aspects of this proposal and that those proposals had received favorable comment. Id. at 63321. The present proposal also seeks SEC approval to delete the rules that govern the OTC Bulletin Board Service (“OTCB”) and cease its operation. The OTCB was created by FINRA to address OTC activity in “penny stocks.” FINRA noted, however, that no member firms have quoted on the OTCB since October 2019 and FINRA believes that the continued operation of the OTCB does not serve any benefit to investors or the marketplace and is an unnecessary drain on FINRA’s resources. Moreover, FINRA believes that the addition of Rule 6439 would provide the same benefits for penny stocks that the OTCB was designed to provide. Id. at 63315, 65518-65519.

⁴ As of August 2020, FINRA was aware of two member IDQs: Global OTC and OTC Link. 85 FR at 63320.

subscribers within 5 business days following their establishment or implementation of a material change.⁵

- Fair access. Paragraph (b) would require an IDQS to establish non-discriminatory written standards for granting access to quoting and trading on its system that do not unreasonably prohibit or limit any person in respect to the services offered by the IDQS.⁶ The standards must be prominently disclosed within five business days of establishment or material change.⁷
- Data products. Paragraph (e) would require an IDQS to provide on its website a written description of each OTC Equity Security order- or quotation-related data product offered by the IDQS and related pricing information. The descriptions must be accurate and up-to-date and available at least two business days in advance of offering the product.⁸
- Systems integrity. Paragraph (f) would require an IDQS to provide FINRA with prompt notification when it reasonably becomes aware of any non-de minimis systems disruption that degrades, limits, or otherwise adversely affects the IDQS's functionality with respect to trading or distribution of market data. The notification would include a brief description of the event, its impact, and resolution efforts.⁹
- The following requirements would apply only to an IDQS that does not automatically execute all orders presented for execution against displayed quotations for which a member subscriber has a “firm quote” obligation under FINRA Rule 5220:¹⁰
 - Backing away. Paragraph (c) would require such an IDQS to establish, maintain, and enforce written P&P to address instances of unresponsiveness when orders are presented to trade with firm quotations displayed on the IDQS (colloquially called “backing away” from a firm quote). At a minimum, the P&P must specify an efficient process for: (i) monitoring subscriber unresponsiveness; (ii) subscribers to submit complaints to the IDQS regarding potential instances of unresponsiveness; (iii) documenting the subscriber’s rationale for unresponsiveness; and (iv) determining specified steps when an instance or repeated unresponsiveness may have occurred.¹¹
 - Reporting. Paragraph (d) would require such an IDQS to report on a monthly basis aggregate and order-level information to assist FINRA in surveilling for member compliance with firm quote obligations and unresponsiveness.

Comments on the proposal are due by October 28, 2020.

⁵ 85 FR at 63316.

⁶ FINRA notes that this requirement is consistent with the “fair access” requirement of Regulation ATS. Rule 301(b)(5) of Regulation ATS imposes fair access requirements when an alternative trading system subject to the regulation exceeds certain trading volumes in subject securities. The fair access requirements of the proposed rule would apply to an IDQS regardless of its trading volume in OTC securities.

⁷ 85 FR at 63316-63317.

⁸ Id at 66318. The rule would not preclude an IDQS from negotiating lower fees with customers, provided that the IDQS discloses on the website the circumstances under which it may do so.

⁹ 85 FR at 63318. If an IDQS were an “SCI alternative trading system” as defined in Rule 1000 of Regulation SCI, it could provide FINRA with the same information submitted to the SEC concerning the occurrence of a systems disruption pursuant to Rule 1002(b) of Regulation SCI. While the requirements of Rule 6439(f) would apply to all IDQSs, the rule is not intended to apply all of the requirements of Regulation SCI to an IDQS that is not subject to that regulation.

¹⁰ FINRA notes that currently it is aware of only one IDQS that does not match and auto-execute subscriber orders. 85 FR at 63317 n.22.

¹¹ 85 FR at 63317.