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One Minute Trade Reporting: Considerations for Firms as They Prepare

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In January 2024, the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB) filed their proposals with the Securities and Exchange Commission (SEC) to decrease the time to report fixed income securities transactions from fifteen minutes to one minute from the time of trade[1]. If approved, these changes will have wide reaching impacts on the fixed income markets, and more specifically, firm compliance programs, perhaps more so than any other rule update concerning this market in recent years.

Background

To provide some context, fixed income markets are largely decentralized and rely heavily on manual trade processing. Voice trades, where one trader will pick up the phone and call another to make a deal on buying or selling a bond, are still incredibly common. While considerable efficiencies have been gained in the past several years resulting in more transparency and information availability, the fixed income markets are still miles behind the equity markets.

Still, the SEC has, as we all know, taken a progressive stance on regulation, and has encouraged the self-regulatory organizations to make progress in this space. There have been debates about shrinking this fifteen-minute time frame to, say 10 minutes or even 5 minutes over the past couple of years, but the Commission has been firm in its desire for an almost immediate reporting requirement. As such, the most recent proposals put forth by FINRA and the MSRB would require firms to report fixed income transactions within one minute from the time of trade, with a few notable exemptions.

Exemption – Limited Trading Activity

The first exemption would apply to what the proposals refer to as firms with "limited trading activity". The proposal would permit firms that engage in fewer than 4,000 TRACE[2]-eligible securities or 1,800 municipal securities transactions during at least one of the prior two consecutive calendar years to continue reporting their trades within fifteen minutes. While this would provide relief to those in the industry that may be disproportionally impacted (i.e.,small firms), firms that qualify for this exemption still would have work to do.

FINRA Rule 6730 Supplementary Material .03 already requires firms to maintain written policies and procedures to ensure that they report trades as soon as practicable (note: not just within 15 minutes). The MSRB's proposal includes an update to Rule G-14 to add new supplementary material that will require the

same in the municipal market. Thus, all firms, even those that can rely on this limited trading exemption, need to review their order handling and trade reporting processes, as well as the related written supervisory procedures, and ensure trades are being reported as quickly as possible.

Another consideration with the limited trading exemption is that the proposals would require firms to "confirm annually" that they qualify for this exemption. The proposals do not state exactly what this confirmation should look like, but one suggestion provided in the proposals is that the broker-dealer could confirm its eligibility by cross-checking its internal trade records with FINRA or MSRB compliance tools that provide a dealer's transaction volume for a given year. A broker-dealer would be required to maintain evidence of this confirmation as a part of its books and records.

Firms that believe they may qualify for the limited trading activity exemption may want to consider performing this type of analysis now. Firms could do this by reviewing their overall volume in TRACE eligible and municipal securities over the last five years, for example, to see a) their overall annual volume in these securities, and b) what the trends in volume look like over time. If a firm has either been above the aforementioned thresholds that would allow it to qualify for the exemption, or its volumes are trending upward over time, it is important to make note of that. Once a firm's volume exceeds that activity threshold, it would only be afforded a three-month grace period before it would be required to start reporting trades within one minute. If systematic changes are necessary to accommodate one minute reporting, it behooves a firm to have some awareness of when this shift might occur.

Exemption – Manual Trades

The second exemption covers "trades with a manual component", or manual trades. The proposals define this as "a transaction that is manually executed or where a dealer must manually enter any of the trade details or information necessary" for reporting.

Both proposals identify a few scenarios that firms may encounter for which manual handling would be expected (i.e., voice trades, allocations, or trades where the CUSIP is not set up in the firm's system). However, the scenarios listed in the proposals are not all inclusive. The proposal suggests that firms should review their trade reporting processes and understand in what situations manual reporting is required – even if a firm qualifies for the limited trading activity exemption. Part of the reason for this is because all manually handled trades will be required to be reported with a new trade reporting indicator. This is similar to what is expected when reporting equities and options transactions to the Consolidated Audit Trail (CAT).

In light of this, firms should consider conducting a deep dive review of their trade reporting practices to identify and map out which trades would fall into this category. There are many reasons why a trade may need to be manually reported, and those will likely vary from firm to firm. Moreover, conducting this type of review may identify certain practices or behaviors that could easily be remediated and may result in creating efficiencies or automation in that trade reporting scenario, which the MSRB specifically highlights as a goal of its proposal.

Policies & Procedures

Firms should also consider reviewing their current policies and procedures for TRACE and RTRS[3] trade reporting, but not only because of the proposal change in reporting time. The proposals strongly emphasize the importance of ensuring that trades are reported as soon as practicable. As previously mentioned, FINRA Rule 6730 Supplementary Material .03 currently requires firms to adopt policies and procedures to comply with this requirement. MSRB Rule G-14 would be updated to include new supplementary material to require this.

We encourage firms to think about their current trade workflow, and specifically, whether it is designed to report trades as soon as practicable. Straight-though processing[4] certainly makes this more possible, but this

may just not be an option for all firms or trading scenarios.

One other item to note – recent industry enforcement trends have highlighted the fact that FINRA wants specificity in firm policies and procedures. Regarding these proposals, firms should identify in their policies and procedures the specific steps they must take to ensure they report trades as soon as practicable.

Time of Trade

One interesting addition to the MSRB proposal includes some clarification on the definition of "Time of Trade". The rules define this as the time when all material terms of the transaction have been decided. The proposal states that "dealers should be clear in their communications regarding the final material terms of the trade and how such terms would be conveyed between the parties to ensure that such a valid contract has been formed". This is noteworthy because the FINRA and RTRS report cards today include a category for "15-minute time of trade difference" – which means that the time of trade the firm reported is more than 15 minutes from the time of trade its counterparty reported. While it remains to be seen how FINRA adjusts this category (or anything with the report cards) given these proposals, firms may consider reviewing their practices and procedures for determining the time of trade, and in particular, how traders are confirming and evidencing the time at which this agreement occurs.

Pattern or Practice of Late Reporting Absent "Reasonable Justification"

Most firms are likely already in the practice of downloading and reviewing their monthly Report Cards from FINRA on TRACE and RTRS reporting statistics. Among other things, these report cards display a firm's percentage of late trades relative to its total trading volume, as well as how that firm's statistics compare to its predetermined peer group.

With the shift to a one-minute reporting period, many firms expect their percentage of late trades to increase to some extent. FINRA acknowledges this in its proposal, stating that this shift may lead to an increase in reporting errors, corrects and late reporting rates, particularly at the beginning. However, it expects that the impact to a firm's accuracy and late reporting will largely be temporary, and that accuracy and timeliness will increase over time as firms adapt to these new obligations.

That last part is key – FINRA expects this shift to be temporary. As this section header suggestions, the proposals include a provision that firms that exhibit a pattern or practice of late reporting must have a "reasonable justification." The proposals highlight a few examples of what would be considered "reasonable" – latencies in the FINRA or RTRS reporting systems, unusual market conditions, etc. In other words, situations that are largely outside of a firm's control.

As firms update their systems to handle this new reporting time frame, a considerable amount of testing should occur. Inaccurate system logic that is improperly coded and insufficiently tested will likely not be considered a reasonable justification. Furthermore, if a firm identifies an issue that is causing them to experience a pattern or practice of late reporting and it subsequently takes several months to fix, that may also not be considered reasonable.

Firms should take the opportunity now to conduct in-depth analysis of the reasoning behind their late trades to fully understand if there is a pattern or practice that exists already and needs to be addressed. As suggested, the regulators expect firms to "review their trade reporting practices and consider the extent to which it can automate some of these reporting processes or implement more efficient trade entry processes to meet these requirements". In sum – if there are issues that can be identified, addressed, and remediated now, firms should take steps to fix them.

Training

It is not too soon to socialize this topic with relevant staff. Firms should also make sure to train all employees involved in the trade reporting process, which may include any trading, operations or compliance professionals. Additionally, as firms review their manual trade scenarios or their late trade reports, they may realize that certain employees or processes are contributing to late reports more than others. This is an opportunity for more targeted training with those employees to help potentially correct behaviors. And of course, as time progresses and we get closer to the rule implementation, a firm will want to make sure its employees are fully informed of these new obligations well in advance of the implementation date.

Summary

As mentioned, these rules are still in proposal form. However, the SEC has made it clear to both FINRA and the MSRB that a narrowed reporting time frame for fixed income securities is a priority, and it is likely these will be approved in some form. Firms have ample opportunity now to review practices, procedures, and policies to see what, if any, efficiencies they can gain. It may be as simple as identifying a person in the process who needs some additional training, or it could mean a rewrite of system logic. Nevertheless, firms should be digging into these reasons now.

While a shift of this magnitude can be challenging, firms can do many things right now to make sure this transition is as painless as possible.

[1] See https://www.finra.org/sites/default/files/2024-01/sr-finra-2024-004.pdf and https://www.msrb.org/sites/default/files/2024-01/SR-MSRB-2024-01_0.pdf (each last visited on February 9, 2024), respectively.

[2] TRACE stands for the Trade Reporting and Compliance Engine. This FINRA system is used to report transactions in most non-exempt fixed income securities.

[3] RTRS stands for Real Time Transaction Reporting System. This MSRB system is used to report transactions in municipal securities.

[4] Straight through processing would mean the firm's back office systems are designed to automatically send trade reports to TRACE and RTRS as transactions are executed.

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