

CAT Reporting Riskless Principal Orders

IM Tech Spec Working Group

Update February 13, 2018

CAT NMS Plan Requirements

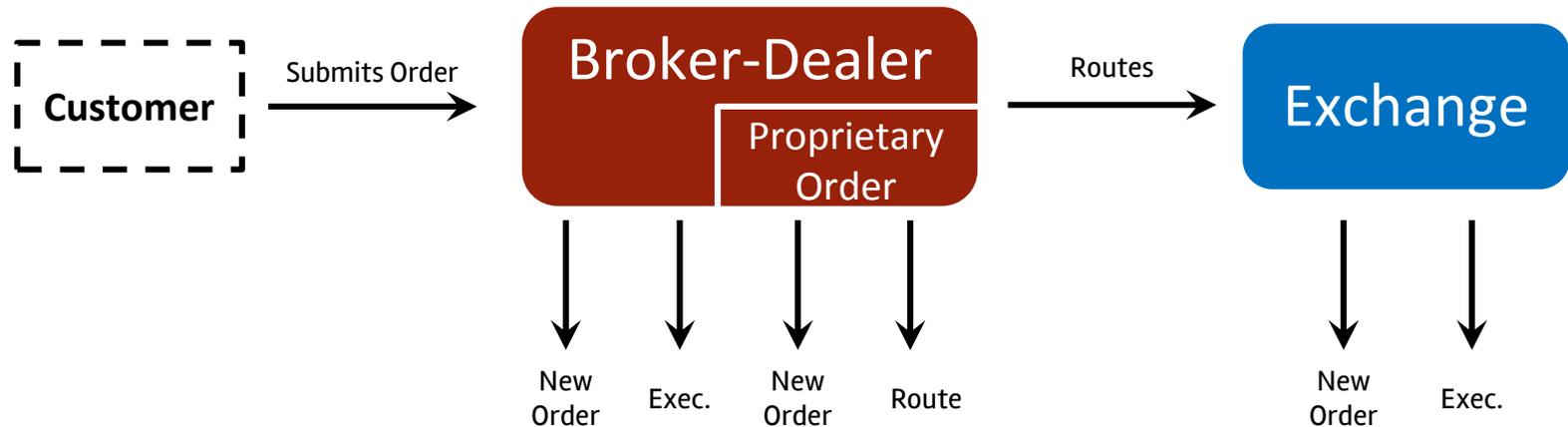
- ▶ The CAT NMS Plan (Appendix D) requires that the Plan Processor, using the daisy chain approach, be able to link all related order events from all CAT Reporters involved in the lifecycle of an order. This includes linking customer orders to “representative” orders created in firm accounts for the purpose of facilitating a customer order (e.g., linking a customer order handled on a riskless principal basis to the street-side proprietary order).
- ▶ The CAT NMS Plan (Appendix D) also requires that life cycles include linkages for an execution of a customer order via the allocation of shares from a pre-existing principal order.

What is Riskless Principal Trade?

- ▶ FINRA Rule 6380A(d)(3)(B) defines a Riskless Principal transaction as:

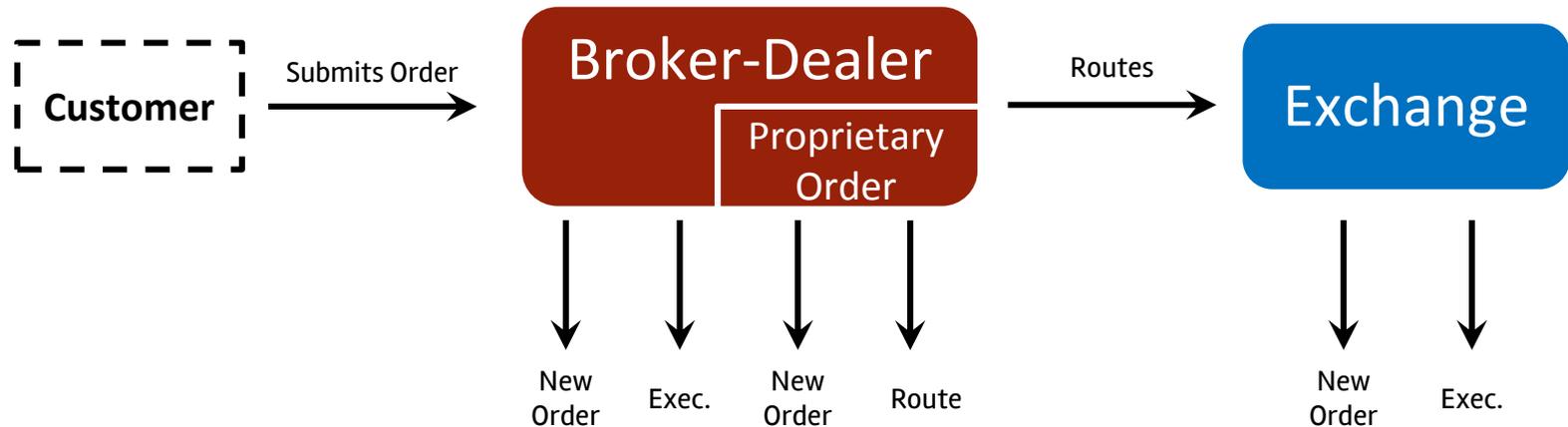
“A...transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell”

Example of a Riskless Principal Transaction



1. Customer submits an order to buy 500 shares of XYZ.
2. Broker-Dealer creates a representative proprietary order to buy 500 shares of XYZ.
3. Broker-Dealer routes the proprietary order to an exchange.
4. Upon execution of the proprietary order, the Broker-Dealer sells the shares to the customer at the same price it purchased the shares on the exchange.

What is Reportable?



Broker-Dealers will be required to report and link (as shown on slide 6):

- The receipt of the original customer order (1).
- The creation of the representative proprietary order (2).
- The route of the representative proprietary order (3).
- The execution of the original customer order (6 and 7).

Exchanges will be required to report and link (as shown on slide 6):

- The receipt of the representative order from the Broker-Dealer (4).
- The execution of the representative order (5).

Linkages in IM Tech Spec V 0.1

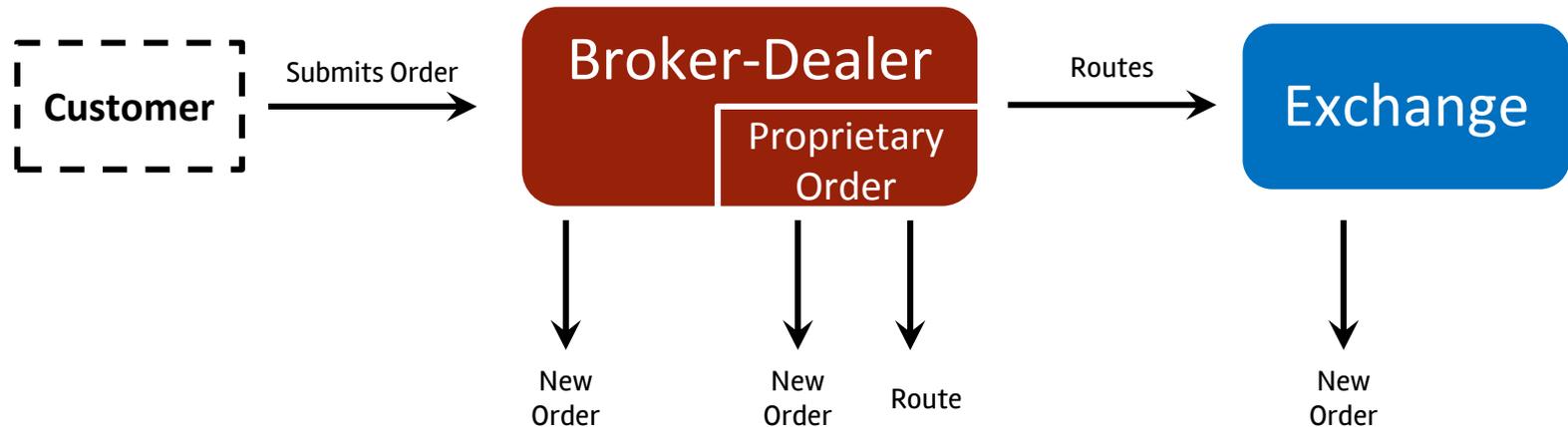
| Event Description | type | reporterMID | routingMID | routingFirm | symbol | quantity | price | side | orderID | tradeID | aggregatedOrders | routedOrderID | buyDetails orderID | buyDetails capacity | buyDetails TapeTradeID | sellDetails orderID | sellDetails capacity | sellDetails TapeTradeID | Reporting Side Capacity | Reported Side Code | Reporting Branch Sequence ID |
|---|-----------|-------------|------------|-------------|--------|----------|-------|------|---------|---------|------------------|---------------|--------------------|---------------------|------------------------|---------------------|----------------------|-------------------------|-------------------------|--------------------|------------------------------|
| 1. Customer submits order | MENO | FRMA | | | XYZ | 500 | 9.99 | B | O12345 | | | | | | | | | | | | |
| 2. BD creates a representative proprietary order | MENO | FRMA | | | XYZ | 500 | 9.99 | B | O12347 | | O12345=500 | | | | | | | | | | |
| 3. BD routes representative proprietary order to an exchange | MEOR | FRMA | EPID | | XYZ | 500 | 9.99 | B | O12347 | | | ABCDXYZ555 | | | | | | | | | |
| 4. Exchange receives the representative proprietary order | EOA | | | EPID | XYZ | 500 | 9.99 | B | E12347 | | | ABCDXYZ555 | | | | | | | | | |
| 5. Representative proprietary order is executed on the exchange | EOT | | | | XYZ | 500 | 9.99 | | | EXYZ124 | | | E12347 | principal | | E12349 | agency | | | | |
| 6. BD sells the shares to the customer at the same price - Reports to CAT | MEOT | FRMA | | | XYZ | 500 | 9.99 | | | T543459 | | | O12345 | | | O12347 | riskless principal | TRF127 | | | |
| 7. BD sells the shares to the customer at the same price - Reports to TRF | non-media | | | | XYZ | 500 | 9.99 | | | | | | | | | | | | R | S | TRF127 |

*Fields in this example are not exhaustive

In accordance with the CAT NMS Plan, the proprietary leg of the transaction must be linked with the customer leg of the transaction. The current version of the IM Technical Specifications provide that:

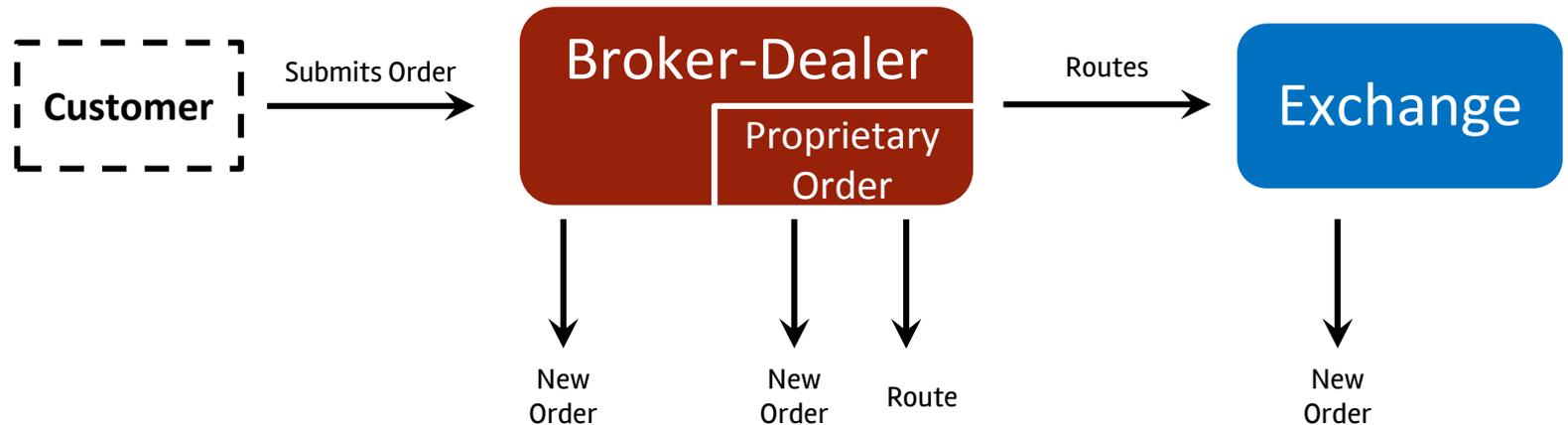
- The “aggregatedOrders” field will be populated on the proprietary new order event, which specifies the “orderID” and quantity associated with the customer order.
- The “orderID” corresponding to both the buy side order (customer order) and the sell side order (proprietary order) will be populated on the customer execution event.

Example of a Riskless Principal Transaction With No Execution



1. Customer submits an order to buy 500 shares of XYZ.
2. Broker-Dealer creates a representative proprietary order to buy 500 shares of XYZ.
3. Broker-Dealer routes the proprietary order to an exchange.
4. The Broker-Dealer does not receive an execution on the exchange, and is unable to execute the original customer order.

What is Reportable?



Broker-Dealers will be required to report and link (as shown on slide 9):

- The receipt of the original customer order (1).
- The creation of the representative proprietary order (2).
- The route of the representative proprietary order (3).

Exchanges will be required to report and link (as shown on slide 9):

- The receipt of the representative order from the Broker-Dealer (4).

Linkages in IM Tech Spec V 0.1

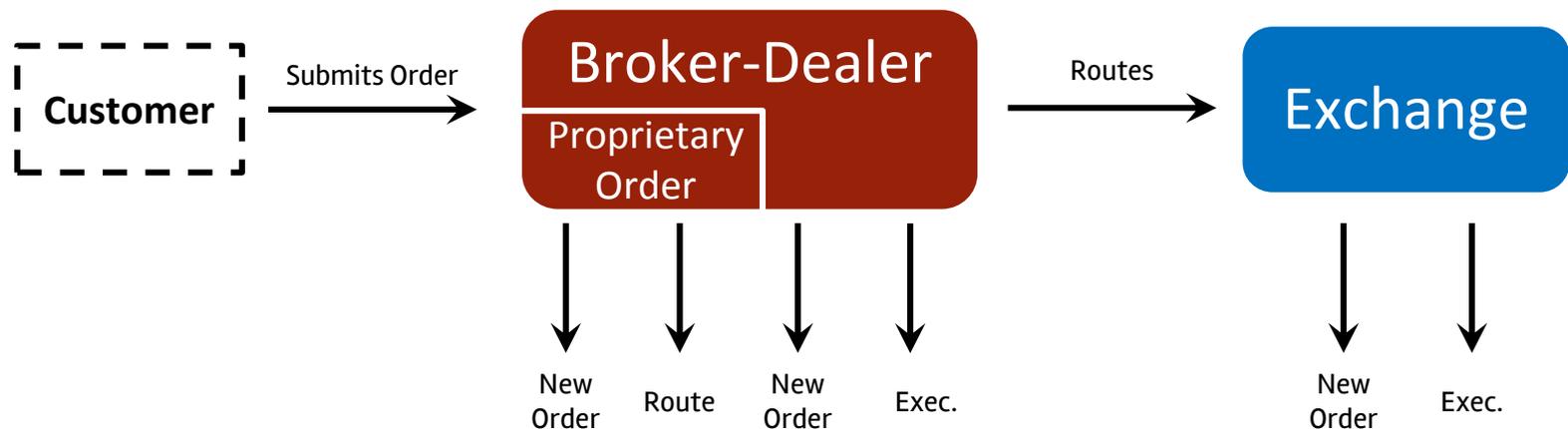
| Event Description | type | reporterIMID | routingIMID | routingFirm | symbol | quantity | price | side | orderID | aggregatedOrders | routedOrderID |
|--|------|--------------|-------------|-------------|--------|----------|-------|------|---------|------------------|---------------|
| 1. Customer submits order | MENO | FRMA | | | XYZ | 500 | 9.99 | B | O12345 | | |
| 2. BD creates a representative proprietary order | MENO | FRMA | | | XYZ | 500 | 9.99 | B | O12347 | O12345=500 | |
| 3. BD routes representative proprietary order to an exchange | MEOR | FRMA | EPID | | XYZ | 500 | 9.99 | B | O12347 | | ABCDXYZ555 |
| 4. Exchange receives the representative proprietary order | EOA | | | EPID | XYZ | 500 | 9.99 | B | E12347 | | ABCDXYZ555 |

*Fields in this example are not exhaustive

The linkage of these orders would be treated the same as the previous Riskless Principal scenario, but the firm would not report an execution of the original customer order.

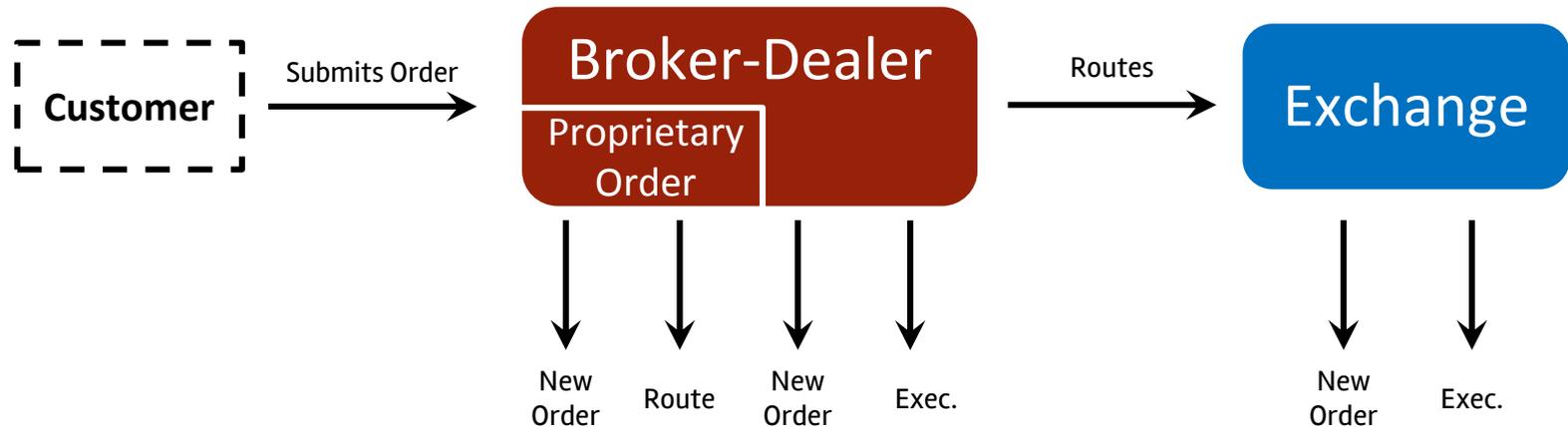
- The “aggregatedOrders” field will be populated on the proprietary new order event, which specifies the “orderID” and quantity associated with the customer order.
- Subsequent cancel events may be required according to the Time-in-force value of the order

Example of Allocation of Shares from Pre-Existing Principal Order



1. Broker-Dealer initiates a principal order to buy 500 shares of XYZ at 9.99 for its market making account.
2. Broker-Dealer routes the order to an exchange.
3. Customer submits an order to buy 100 shares of XYZ at 9.99.
4. Principal order receives a full execution, and the Broker-Dealer must then execute the customer order to satisfy its Manning obligations.

What is Reportable?



Broker-Dealers will be required to report and link (as shown on slide 12):

- The creation of the principal order (1).
- The route of the principal order (2).
- The receipt of the customer order (4).
- The execution of the customer order (6 and 7).

Exchanges will be required to report and link (as shown on slide 12):

- The receipt of the principal order from the Broker-Dealer (3).
- The execution of the principal order (5)

Linkages in IM Tech Spec V 0.1

| Event Description | type | reporterIMID | routingIMID | routingFirm | symbol | quantity | price | side | orderID | tradeID | aggregatedOrders | routedOrderID | buyDetails orderID | buyDetails capacity | buyDetails TapeTradeID | sellDetails orderID | sellDetails capacity | sellDetails TapeTradeID | Reporting Side Capacity | Reported Side Code | Reporting Branch Sequence ID |
|---|-----------|--------------|-------------|-------------|--------|----------|-------|------|---------|---------|------------------|---------------|--------------------|---------------------|------------------------|---------------------|----------------------|-------------------------|-------------------------|--------------------|------------------------------|
| 1. BD initiates principal order for its market making account | MENO | FRMA | | | XYZ | 500 | 9.99 | B | O12347 | | | | | | | | | | | | |
| 2. BD routes principal order to an exchange | MEOR | FRMA | EPID | | XYZ | 500 | 9.99 | B | O12347 | | | ABCDXYZ555 | | | | | | | | | |
| 3. Exchange receives the principal order | EOA | | | EPID | XYZ | 500 | 9.99 | B | E12347 | | | ABCDXYZ555 | | | | | | | | | |
| 4. Customer submits order | MENO | FRMA | | | XYZ | 100 | 9.99 | B | O12345 | | | | | | | | | | | | |
| 5. Principal order is executed on the exchange | EOT | | | | XYZ | 500 | 9.99 | | | XYZ124 | | | E12347 | principal | | E12349 | agency | | | | |
| 6. BD sells the shares to the customer at the same price - Reports to CAT | MEOT | FRMA | | | XYZ | 100 | 9.99 | | | T253498 | | | O12345 | | | O12347 | riskless principal | TRF127 | | | |
| 7. BD sells the shares to the customer at the same price - Reports to TRF | non-media | | | | XYZ | 100 | 9.99 | | | | | | | | | | | | R | S | TRF127 |

*Fields in this example are not exhaustive

In this scenario, the principal order will not have been linked to the customer order in a new order event. Otherwise, this scenario will be treated the same as the previous Riskless Principal scenario. The current version of the Technical Specifications provide that:

- The “orderID” corresponding to both the buy side order (customer order) and the sell side order (proprietary order) will be populated on the customer execution event.

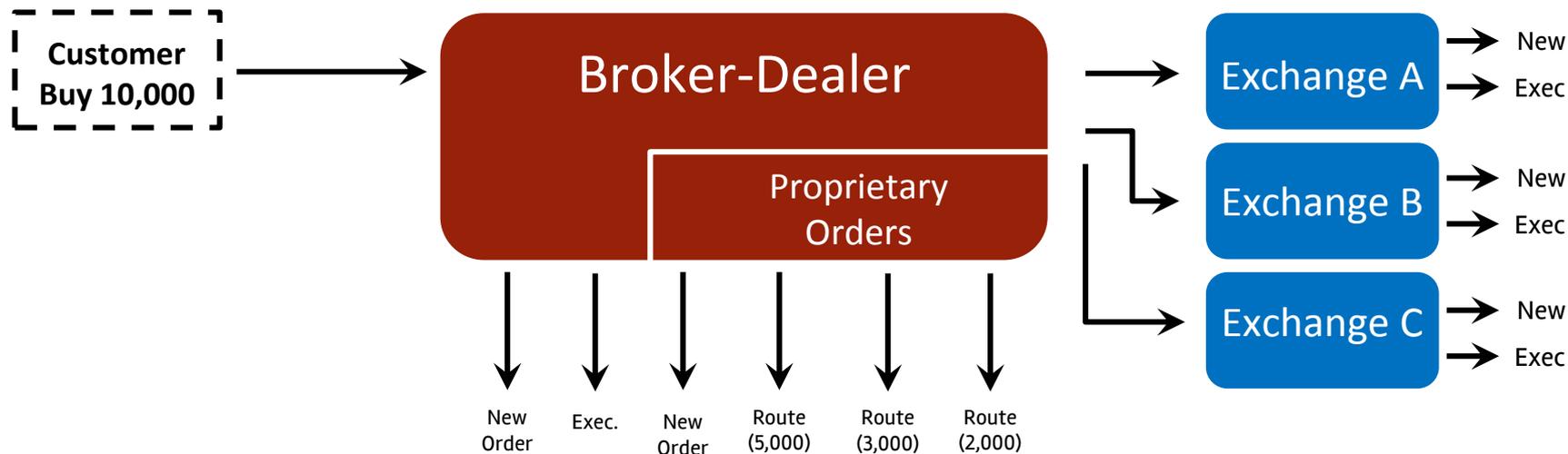
Net Trading

- ▶ While Appendix D explicitly cites riskless principal trades as an example for representative orders, net trading is a similar scenario with price to the customer being the key difference.

- ▶ FINRA Rule 2124 defines a Net Trade as:

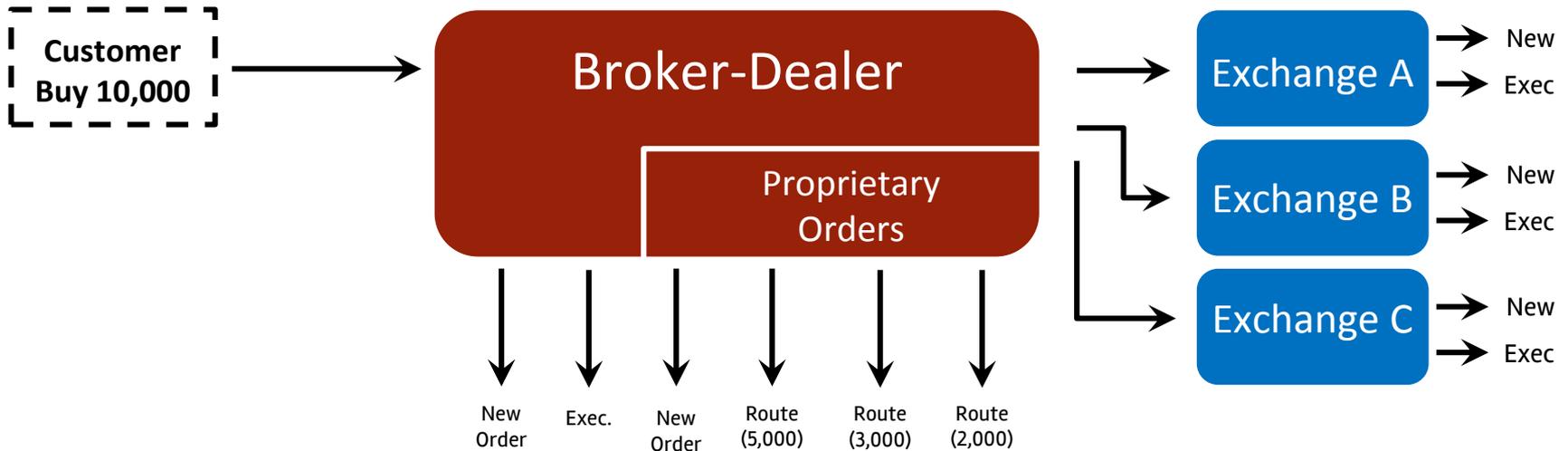
*“...a principal transaction in which a market maker, after having received an order to buy (sell) an equity security, purchases (sells) the equity security at one price (from (to) another broker-dealer or another customer) and then sells to (buys from) the customer **at a different price.**”*

Example of a Net Trade



1. Customer submits an order to buy 10,000 shares of XYZ.
2. Broker-Dealer creates a representative proprietary order to buy a total of 10,000 shares of XYZ.
3. Broker-Dealer routes the representative proprietary order to multiple exchanges.
4. Upon execution, the Broker-Dealer sells the shares to the customer **at a different price** than it purchased the shares on the exchange. The difference in price is generally considered the Broker-Dealer's compensation.

What is Reportable?



Broker-Dealers will be required to report and link (as shown on slide 16):

- The receipt of the original customer order (1).
- The creation of the representative proprietary order (2).
- Each route of the representative order (3, 4 and 5).
- The execution of the original customer order (12 and 13).

Exchanges will be required to report and link (as shown on slide 16):

- The receipt of each child order from the Broker-Dealer (6, 7 and 8).
- The execution of the representative order (9, 10 and 11).

Linkages in IM Tech Spec V 0.1

| Event Description | type | reporterIMID | routingIMID | exchange | routingFirm | symbol | quantity | price | side | orderID | tradeID | aggregatedOrderID | routedOrderID | destinationExchange | buyDetails orderID | buyDetails capacity | buyDetails TapeTradeID | sellDetails orderID | sellDetails capacity | sellDetails TapeTradeID | Reporting Side Capacity | Reported Side Code | Reporting Branch Sequence ID |
|---|-------|--------------|-------------|----------|-------------|--------|----------|-------|------|---------|---------|-------------------|---------------|---------------------|--------------------|---------------------|------------------------|---------------------|----------------------|-------------------------|-------------------------|--------------------|------------------------------|
| 1. Customer submits order | MENO | FRMA | | | | XYZ | 10,000 | 9.99 | B | O12345 | | | | | | | | | | | | | |
| 2. BD creates a representative proprietary order | MENO | FRMA | | | | XYZ | 10,000 | 9.97 | B | O12346 | | O12345=10000 | | | | | | | | | | | |
| 3. BD routes representative proprietary order to an exchange | MEOR | FRMA | EPID | | | XYZ | 5,000 | 9.97 | B | O12346 | | | ABCDXYZ555 | XA | | | | | | | | | |
| 4. BD routes representative proprietary order to an exchange | MEOR | FRMA | EPID | | | XYZ | 3,000 | 9.97 | B | O12346 | | | ABCDXYZ556 | XB | | | | | | | | | |
| 5. BD routes representative proprietary order to an exchange | MEOR | FRMA | EPID | | | XYZ | 2,000 | 9.97 | B | O12346 | | | ABCDXYZ557 | XC | | | | | | | | | |
| 6. Exchange receives the representative proprietary order | EOA | | | XA | EPID | XYZ | 5,000 | 9.97 | B | E12347 | | | ABCDXYZ555 | | | | | | | | | | |
| 7. Exchange receives the representative proprietary order | EOA | | | XB | EPID | XYZ | 3,000 | 9.97 | B | E12348 | | | ABCDXYZ556 | | | | | | | | | | |
| 8. Exchange receives the representative proprietary order | EOA | | | XC | EPID | XYZ | 2,000 | 9.97 | B | E12349 | | | ABCDXYZ557 | | | | | | | | | | |
| 9. Representative proprietary order is executed on the exchange | EOT | | | XA | | XYZ | 5,000 | 9.97 | | | EXYZ127 | | | | E12347 | principal | | E12350 | agency | | | | |
| 10. Representative proprietary order is executed on the exchange | EOT | | | XB | | XYZ | 3,000 | 9.97 | | | EXYZ128 | | | | E12348 | principal | | E12351 | agency | | | | |
| 11. Representative proprietary order is executed on the exchange | EOT | | | XC | | XYZ | 2,000 | 9.97 | | | EXYZ129 | | | | E12349 | principal | | E12352 | agency | | | | |
| 12. BD sells the shares to the customer at a different price - Reports to CAT | MEOT | FRMA | | | | XYZ | 10,000 | 9.99 | | | | | | | O12345 | | | O12346 | principal | TRF126 | | | |
| 13. BD sells the shares to the customer at a different price - Reports to TRF | media | | | | | XYZ | 10,000 | 9.99 | | | | | | | | | | | | | P | S | TRF126 |

*Fields in this example are not exhaustive

The linkage of these orders would be treated the same as the previous Riskless Principal scenario.

- The “aggregatedOrders” field will be populated on the proprietary new order event, which specifies the “orderID” and quantity associated with the customer order.
- The “orderID” corresponding to both the buy side order (customer order) and the sell side order (proprietary order) will be populated on the customer execution event.

Industry Questions/Comments

- ▶ For representative orders that are not filled – is it necessary to link to the representative order to the customer order(s)? **Answer: Yes**
- ▶ For principal or riskless principal executions, are firms required to report execution events for all executions related to the client fill? **Answer: Yes, the execution of the customer order must be reported.**
- ▶ Orders are not typically placed as riskless principal, but are instead filled as riskless principal. Is it supportable to require identification of an order as RP, or just the executions/assignments? **Answer: Only the execution must contain the capacity of RP**
- ▶ Orders are not required to have a capacity. This should be an optional field or conditional when routed to an exchange. It should be noted that orders can be filled in a mixed capacity basis. If this remains a required field it must be defined – does it mean the capacity the sender intends to fill the order in, or the capacity it intends the receiver to fill the order in? **Answer: Capacity is not required on the order, only on the execution.**

Industry Questions/Concerns

- ▶ Orders are not required to have a capacity and are not meaningful when the order is received from a customer. If the order is received from another broker-dealer then capacity may represent the capacity in which the contra broker-dealer intends to fill the order and may be used for trade reporting purposes.
- ▶ Traders may work a Not Held order over the day and decide, after accumulating a position, when filling the order, whether to fill it on a principal or riskless basis. Must BDs decide after the fact whether the market facing order was placed by the broker in anticipation of this riskless execution? (risklessorderIDs is required on riskless trade reports)
Answer: if the order was originated specifically to facilitate execution of the customer order, it must be linked to the customer order.

Industry Questions/Concerns

- ▶ Foreign Broker/Dealer ABC may route an order as Principal to US Broker/Dealer DEF; US Broker/dealer DEF is an Agent of the Foreign B/D, so it will route the order to a US exchange as an Agent. Which “capacity” needs specifically to be reported on the New Order by the US Broker/dealer DEF: the capacity in which they received the order (Agency) or the capacity in which the order was routed to them by ABC (Principal)? **Answer: Capacity is not required on the order, only on the execution.**