



September 25, 2013

**Via Electronic Submission**

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

**Re: Proposed Rule Changes Relating to Wash Sale Transactions and FINRA Rule 5210; File No. SR-FINRA-2013-036**

Dear Ms. Murphy:

Managed Funds Association (“**MFA**”)<sup>1</sup> appreciates the opportunity to submit comments to the Securities and Exchange Commission (“**SEC**” or “**Commission**”) on the Financial Industry Regulatory Authority, Inc.’s (“**FINRA**”) proposal to add supplementary material to FINRA Rule 5210 (Publication of Transactions and Quotations) regarding wash sale transactions (the “Proposed Rule”).<sup>2</sup> MFA believes that the unintentional interaction of orders from one or more algorithms from a single firm (“self-matches”) should not be a violation of Rule 5210. We further believe that in U.S. equity markets, FINRA Members (“**Members**”) should take reasonable precautions to prevent self-matches that are publicly reported. We also strongly support the further development by exchanges and alternative trading systems, of software functionality that will help users prevent self-matches. We submit comments on the Proposed Rule and related matters for the Commission and FINRA’s consideration.

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<sup>1</sup> MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

<sup>2</sup> SEC Release No. 34-70276, hereinafter “Proposing Release”, available at:  
<http://www.sec.gov/rules/sro/finra/2013/34-70276.pdf>

## **I. Introduction**

MFA recognizes that in the automated trading environment where firms increasingly use algorithms to make trading decisions, there is an increased risk that a firm's orders from unrelated algorithms may cross. We support the Proposed Rule's requirement that "Members must have policies and procedures in place that are reasonably designed to review their trading activity for, and prevent, wash sale transactions."<sup>3</sup> At the same time, regulators should take an even-handed approach in preventing the occurrence of inadvertent self-matches. In general, we believe the increase in automated trading has been beneficial to investors by increasing market liquidity and lowering transaction costs. Thus, from our perspective it's important that a Proposed Rule does not create a chilling effect on legitimate trading.

## **II. Scope of the Proposed Rule**

MFA believes that the Proposed Rule should be limited to equity market transactions executed and reported in the United States. As trading becomes increasingly cross-border, we believe it would be helpful for FINRA to clarify the scope of the Proposed Rule. In the Proposing Release, FINRA explains that it is concerned that self-matching trades may create the misimpression of active trading in a security.<sup>4</sup> Foreign markets are subject to their own home-state regulatory frameworks. FINRA should focus its resources on domestic trading and allow local regulators to address trading activity in their marketplaces. With respect to transactions that are not publicly reported, there is no regulatory purpose served by applying the Proposed Rule. Finally, we believe that most of the focus by FINRA has been on U.S. equity markets; and, as such, without further analysis of the impact of the Proposed Rule on other markets, such as corporate bond, treasury, municipal securities or listed options markets, the Proposed Rule should be limited to the U.S. equity markets.

## **III. Inadvertent Self-Matches by Independent Trading Algorithms Should Not Trigger Wash Trade Liability Just as Inadvertent Self-Matches by Independent Decision Makers Will Not Trigger Wash Trade Liability**

We believe the Proposed Rule should be consistent with well-settled securities case law on wash sales and should not create a new legal standard.<sup>5</sup> In this respect, we think it is important that the Proposed Rule acknowledge that "[t]ransactions that originate from unrelated algorithms or separate and distinct trading strategies within the same firm . . . would not be

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<sup>3</sup> *Id.*

<sup>4</sup> Proposing Release at p. 4.

<sup>5</sup> *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977); *In the Matter of J.A. Latimer & Co., Inc.*, 38 S.E.C. 790 (1958); and *In the Matter of Thornton & Co.*, 28 S.E.C. 208 (1948).

considered wash sales . . . unless the transactions were undertaken for manipulative or other fraudulent purposes.”<sup>6</sup> Just as self-matching orders that are independently initiated for legitimate and separate business purposes by independent decision makers would not be considered a wash trade violation; the Proposed Rule should make clear that unrelated trading algorithms will likewise not trigger liability.

We believe the Proposed Rule should clarify that algorithms are not “related” merely because they share common infrastructure, inputs such as market data or certain characteristics of a security, or had common quantitative researchers. Independent or unrelated trading algorithms operate as independent decision makers because they gauge market conditions and related factors without any input from other independent trading algorithms when calculating their orders. It is common for personnel to oversee numerous automated trading systems, and such common oversight does not increase the risk of intentional self-matches. Unlike manual trading teams, independently operating automated trading systems, by their very nature, are not capable of communicating with each other even if they are overseen by common personnel.

The Proposed Rule should not automatically presume that algorithms in the most discrete trading units are related. Oftentimes, unrelated algorithms may be housed in the same aggregation unit because they share common oversight staff and the algorithm strategies are different. We propose that FINRA at least note that the presumption that algorithms in a discrete unit are related is rebuttable if a Member shows a reasonable basis to believe that any self-matches were not the result of any coordination between the trading algorithms.

#### **IV. MFA Supports Further Development by Marketplaces of Software Functionality to Prevent Self-Matches**

MFA strongly supports the development by marketplaces of functionality to prevent self-matches. We note that many marketplaces already offer an array of tools to prevent self-matches, but we urge the SEC and FINRA to encourage marketplaces and FINRA Members to develop or continue development of greater configurability and accessibility of such functionality to accommodate the varied trading needs among market participants. For example, currently, software is available to prevent self-match activity under a market participant identifier, but not by aggregation unit or trading desk.

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<sup>6</sup> Proposing Release at p. 2.

**V. Conclusion**

MFA would like to thank the Commission and FINRA for the opportunity to comment on the Proposed Rule. We hope that our perspective will inform the rulemaking process and help to bring about clarity through collaboration. We look forward to working with the Commission and FINRA to make further improvements to these requirements. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Jennifer Han, Associate General Counsel, or the undersigned at (202) 730-2600.

Sincerely,

/s/ Stuart J. Kaswell

Stuart J. Kaswell  
Executive Vice President & Managing Director,  
General Counsel

CC: The Hon. Mary Jo White, Chairman  
The Hon. Luis A. Aguilar, Commissioner  
The Hon. Daniel M. Gallagher, Commissioner  
The Hon. Kara M. Stein, Commissioner  
The Hon. Michael S. Piwowar, Commissioner