Securities Industry and
Financial Markets Association

August 23, 2007

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Mr. Marc Menchel
Executive Vice President
and General Counsel for Regulation
Financial Industry Regulatory Authority
Office of General Counsel
1735 K Street, NW
Washington, DC 20006-1506

Re: Release No. 34-55745, File No. SR-NASD-2007-030,
NASD Proposed Rule Change Relating to Trade Reporting
Obligations for Transactions in Foreign Equity Securities

Dear Ms. Morris and Mr. Menchel:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to provide the Securities and Exchange Commission (the "Commission") and the Financial Industry Regulatory Authority ("FINRA") with comments relating to the proposed rule change (the "Proposed Amendment") filed with the Commission by FINRA's predecessor, the National Association of Securities Dealers, Inc. (the "NASD"), to NASD Rule 6620 for the purpose of codifying a

[1] SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington, D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

member's trade reporting obligations with respect to transactions in foreign equity securities.[2]

We appreciate and support FINRA's efforts with respect to this Proposed Amendment to clarify the application of NASD Rule 6620. We believe, however, that an additional measure should be taken in connection with a point raised by FINRA regarding American Depositary Receipt ("ADR") swap or "cross book" transactions in its Notice to Members 07-25 (the "Notice") apprising members of the Proposed Amendment. For the reasons described below, we suggest that the Proposed Amendment be further amended to exempt these transactions from the reporting requirements of NASD Rule 6620.

I. Background of ADR Swap Transactions

ADRs were created to address the difficulties involved for U.S. persons in purchasing shares of foreign issuers that trade on foreign exchanges. ADRs are receipts issued by depositaries that represent shares in the foreign issuer. "An ADR is a negotiable instrument that represents an ownership interest in a specified number of securities, which the securities holder has deposited with a designated bank depositary."[3] Trading in ADRs has enabled investors to transact on either the particular foreign exchange or in the U.S. markets (or both), and to thereby hedge certain risks, as well.

In the Notice, FINRA stated that it had received inquiries relating to trade reporting requirements for ADR swap or "cross-book" transactions. For purposes of this letter, an "ADR/Ordinary Swap" transaction is one in which an investor who holds either an ADR or the underlying ("Ordinary") shares relating to such ADR, is seeking to obtain its opposite side (*i.e.*, either the Ordinary share or the ADR, as applicable). Such a transaction can be obtained directly through the depositary bank for the particular issuer, whereby either the investor tenders an ADR and is issued the corresponding Ordinary share, or the investor tenders an Ordinary share and is issued an ADR in return. In each case, no trade is deemed to have occurred and it is not reported to FINRA for public dissemination.

ADR/Ordinary Swap transactions executed through a depositary bank typically carry a fee of $0.05 per share. Understandably, investors have sought more economical ways of accomplishing these ADR/Ordinary Swap transactions, particularly for large transactions. Intermediary brokers have sought to fill this need by effecting the ADR/Ordinary Swap transaction without the involvement of the depositary bank. In this version of the ADR/Ordinary Swap transaction, the broker either completes the swap using securities from its own inventory (or that of an affiliate), or it matches separate

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[2] Release No. 34-55745, File No. SR-NASD-2007-030 (May 11, 2007).

[3] Release No. 34-55540; International Series Release No. 1301; File No. S7-12-05 (Apr. 5, 2007).

investors who seek the opposite side of the ADR/Ordinary Swap. For example, in a circumstance where Issuer X has outstanding ADRs that represent the underlying Ordinary shares on a one-for-one basis, in the first instance Customer A transfers 100 ADRs to the broker, and the broker, essentially standing in the place of the depositary bank, transfers 100 Ordinary shares to Customer A from its inventory in a principal transaction. In the second instance, Customer A transfers 100 ADRs to the broker, as intermediary, who then transfers the ADRs to Customer B in a riskless principal transaction. Simultaneously, Customer B transfers 100 Ordinary shares through the intermediary broker to Customer A. At the completion of the transaction, the customers (or, in the first instance, the broker) have exchanged their form of ownership in Issuer X and each beneficially owns the same number of shares of the underlying security. Thus, they have swapped the form of security they own without changing their beneficial ownership position in Issuer X. Brokers typically charge $0.01 per share for arranging these transactions.

II. ADR/Ordinary Swap Transaction Reporting

FINRA stated in the Notice that an ADR/Ordinary Swap transaction executed by a broker must be reported to FINRA. We suggest that instead these transactions should be exempt from the reporting requirements for two reasons: First, the ADR/Ordinary Swap transaction has the same effect and is essentially the same exchange whether it is executed through a broker or through a depositary bank, and thus the two methods of execution should be treated the same for reporting purposes. Second, by reporting ADR/Ordinary Swap transactions, the trading volume in these securities would be inappropriately and potentially significantly inflated despite no actual change in the beneficial ownership of the issuer's securities, thereby misleading the markets and investors for such securities.

A. ADR/Ordinary Swaps Should be Reported Consistently

ADRs and Ordinary shares represent two different forms of the same ownership in an issuer. Whether the investor holds one or the other, the investor's beneficial ownership of the issuer is not impacted. Accordingly, ADR/Ordinary Swap transactions result in no change in beneficial ownership of the issuer's securities, regardless of whether they are executed through a broker or through a depositary bank. In each case, the investor is merely changing the form of his or her ownership interest in the issuer. Whether the investor swaps Ordinary shares for ADRs or ADRs for Ordinary shares, the investor's actual ownership percentage in the issuer and the number shares he is entitled to vote remain the same.

It is accepted practice that an ADR/Ordinary Swap transaction with a depositary bank would not and should not be reported as a trade to FINRA and disseminated to the public as such. We suggest that these swaps be treated the same for

reporting purposes regardless of whether they are executed by a broker or depositary bank.

B. Reporting ADR/Ordinary Swaps Inflates Trading Statistics

ADR/Ordinary Swap transactions are executed for a variety of reasons, including those relating to hedging foreign currency risk and simply for the convenience of the investor. By reporting these transactions in which no change of beneficial ownership by investors has occurred, the volume in the ADRs is artificially inflated. As a result, the market could be substantially misled as to the nature of the trading activity in the securities, particularly for thinly traded ADRs.

The Commission and FINRA have long been vigilant in their efforts to ensure the integrity of trading reports and information that is disseminated to the public. NASD Rule 6620(e) contemplates that only those activities that are relevant to the market should be reported, such as where a buyer and seller have exchanged ownership positions at the current market price. The exemption from reporting transactions under NASD Rule 6620(e)(3), in which buyer and seller have agreed on a price substantially unrelated to the current market, is an example of the effort to ensure that data unrelated to the actual market price for a security is not reported as such. Likewise, with ADR/Ordinary Swap transactions, we believe that reporting trading volume in a security where no actual market related activity has occurred would be inappropriate. Moreover, the ADR/Ordinary Swap transaction is akin to an exercise of a vested option, in that the investor is changing the form of his ownership in the issuer without changing his beneficial ownership.[4] Again, NASD Rule 6620(e)(4) exempts from the reporting requirements purchases or sales of securities effected upon the exercise of an option for this very reason. Accordingly, the principles of ensuring the integrity of reported market data underlying NASD Rule 6620 militate toward the adoption of an exemption for ADR/Ordinary Swap transactions for the same reasons such exemptions were provided in subparts (3) and (4) of NASD Rule 6620(e).[5]

We understand that, historically, many firms did not report these transactions as they believed that because there was no change in ownership of the underlying securities reporting the transaction to the tape would actually be improper. Obviously, an unscrupulous investor could create the appearance of significant volume in an ADR merely by engaging in ADR/Ordinary Swaps. Of course, this sort of activity is prohibited by Section 9(a) of the Securities Exchange Act of 1934, as amended; and

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[4] We note that Rule 16b-6(b) under the Securities Exchange Act of 1934, as amended, provides that the exchange of a derivative security for the underlying security is exempt from the application of Section 16, as it does not represent a change in beneficial ownership. *See* Release No. 34-37260 (May 31, 1996).

[5] Similarly, FINRA has recently recognized the need to exempt certain other transactions, including the settlement of options and credit default swaps, from the reporting requirements of NASD Rule 6230. File No. SR-FINRA-2007-007 (Aug. 10, 2007).

the same principles of ensuring accurate reporting to the markets that underlie Section 9(a) apply in this circumstance.[6] Accordingly, we believe that requiring such reporting

would inappropriately inflate the volume for ADRs generally, and would provide the opportunity for trade volume manipulation by unscrupulous investors.

C. Proposed Reporting Exemption

We suggest that this issue could be appropriately addressed with the addition of a new subpart to the Proposed Amendment. This additional provision would exempt ADR/Ordinary Swap transactions from the application of Rule 6620 and provide for consistent reporting of these transactions by both brokers and depositary banks. It would also avoid the potentially misleading and inaccurate reporting discussed above.

We suggest adding to the proposed amendment to Rule 6620 a new subpart (g)(C) as follows:

"(C) the transaction involves the trade of foreign equity securities underlying American Depository Receipts and a corresponding number of American Depository Receipts that does not result in a change in beneficial ownership of the underlying foreign equity securities by any party thereto."

III. Conclusion

For the reasons stated above we believe that ADR/Ordinary Swap transactions should be exempt from the reporting requirements of NASD Rule 6620. We have suggested that such exemption could be accomplished in the manner described above.

We wish to thank the Commission and its staff, as well as FINRA and its staff, for their work in developing the Proposed Amendment and for this opportunity to comment on them. We would be pleased to discuss any of these comments in greater

[6] *See, e.g.*, In the Matter of Richard M. Kulak, Admin. Proc. File No. 3-8509, 1995 WL 568769 at 9 (Sept. 26, 1995) ("The investing public is deceived when, as here, during an eighteen month trading period, at least 36.55% of the total reported volume in a particular security represents a complete fiction in that there was absolutely no change in beneficial ownership of that stock.") .

detail, or to provide any other assistance that would help facilitate the Commission's review of the Proposed Amendment. If you have any questions, please do not hesitate to contact the undersigned (646-637-9224), or Stephen P. Wink of Cahill/Wink LLP, counsel to SIFMA in this matter (646-378-2105).

Very truly yours,

Robert Toomey
Managing Director and
Associate General Counsel