

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65791; File No. SR-FINRA-2011-053)

November 18, 2011

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Granting Approval of Proposed Rule Change to Amend Certain TRACE Rules

I. Introduction

On September 22, 2011, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to consolidate all TRACE-Eligible Securities transaction processing and data management on a single technology platform, the Multi Product Platform (“MPP”), and make various changes to the rules governing how TRACE-Eligible Securities other than Asset-Backed Securities are required to be reported. The proposed rule change was published for comment in the Federal Register on October 6, 2011.³ The Commission received two comments in response to the proposal.⁴ On November 10, 2011, FINRA responded to the comments.⁵ This order grants approval of the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 65459 (September 30, 2011), 76 FR 62128 (“Notice”).

⁴ See letter from Suzanne H. Shatto, dated October 20, 2011 (“Shatto Letter”); letter from Christopher Killian, Vice President, Securities Industry and Financial Markets Association (“SIFMA”), to Elizabeth M. Murphy, Secretary, Commission, dated October 27, 2011 (“SIFMA Letter”).

⁵ See letter from Sharon Zackula, Associate Vice President and Associate General Counsel, FINRA, to Elizabeth M. Murphy, Secretary, Commission, dated November 10, 2011 (“FINRA Letter”).

II. Description of the Proposal

Currently, transactions only in TRACE-Eligible Securities that are Asset-Backed Securities are processed on the MPP.⁶ The proposed rule change would make certain amendments to the reporting requirements of Rule 6730 that would permit FINRA to migrate all other TRACE-Eligible Securities to the MPP. These new requirements are substantially similar to those that currently apply to transactions in Asset-Backed Securities and are described below.

TRACE-Eligible Securities Transactions Executed on a Non-Business Day

Currently, as set forth in Rules 6730(a)(1)(D) and 6730(a)(2)(B), transactions in TRACE-Eligible Securities, except Asset-Backed Securities, that are executed on a weekend, holiday, or other day when the TRACE system is not open must be reported the next business day (T + 1), designated “as/of,” and are subject to two unique requirements. First, the date of execution (“Trade Date”) reported to TRACE is not the actual date the trade was executed; instead, a member must report as the Trade Date the day (*i.e.*, T + 1) that the report must be timely submitted. Second, the execution time reported must be “12:01:00 a.m. Eastern Time” (“00:01:00”), instead of the actual Time of Execution.⁷ As described in the Notice, the two requirements were established at the inception of TRACE because, at that time, the TRACE system did not recognize any day on which the TRACE system is closed as a valid Trade Date, and the two current required elements allow FINRA to distinguish transactions in TRACE-Eligible Securities executed on non-business days from all other reported transactions.

⁶ “TRACE-Eligible Security” and “Asset-Backed Security” are defined in, respectively, Rule 6710(a) and Rule 6710(m).

⁷ “Time of Execution” is defined in Rule 6710(d). Also, when the reporting method used includes a “special price memo” field, the member must enter the actual date of execution and Time of Execution in such field.

FINRA has enhanced the TRACE system to recognize, for all types of TRACE-Eligible Securities, any calendar date as a valid Trade Date. Accordingly, the proposed rule change would amend Rules 6730(a)(1)(D) and 6730(a)(2)(B) to delete in both provisions the two data elements described above, and instead require members to report transactions executed on non-business days in the same manner that transactions executed after or before TRACE System Hours on business days are reported currently.⁸ The proposal also would combine and renumber certain rules and incorporate minor technical changes.

Size (Volume), Commission, and Settlement Terms

In addition, the proposed rule change would amend the technical requirements for reporting the size (volume) of a transaction, the commission (if any), and the settlement of transactions in TRACE-Eligible Securities, other than Asset-Backed Securities.

Currently, FINRA requires members to report the size (volume) of a transaction in a TRACE-Eligible Security, other than an Asset-Backed Security, by reporting the number of bonds transacted.⁹ For example, a sale of corporate bonds having a par or principal value of \$10,000 is reported as a sale of ten bonds. The proposal would amend Rules 6730(c)(2) and 6730(d)(2) to require a member to report the size of such transactions using the total par value or principal value traded, rather than the number of bonds.¹⁰

The proposed rule change would make similar change to the reporting of commissions. Under current Rules 6730(c)(11) and 6730(d)(1), in cases where a commission is charged in a

⁸ “TRACE System Hours” is defined in Rule 6710(t).

⁹ See Rules 6730(c)(2) and 6730(d)(2).

¹⁰ Previously, FINRA adopted similar provisions for reporting the size (volume) of transactions in Asset-Backed Securities that do not amortize. See Securities Exchange Act Release No. 61566 (February 22, 2010), 75 FR 9262 (March 1, 2010) (order approving File No. SR-FINRA-2009-065).

transaction in a TRACE-Eligible Security, the commission must be reported “stated in points per bond (e.g., for corporate bonds, 1 point equals \$10.00 per bond).”¹¹ As amended by the proposal, Rules 6730(c)(11) and 6730(d)(1) would require members to report the total dollar amount of the commission, rather than the points per bond.¹²

The proposed rule change also would simplify the requirements for reporting the settlement of a transaction in a TRACE-Eligible Security. Currently, as provided in Rule 6730(d)(4)(B)(i), if a transaction, other than a transaction in an Asset-Backed Security, will not settle on T + 3, a member must report the settlement using one of three modifiers.¹³ To streamline the requirements regarding settlement, new Rule 6730(c)(12) would require a member simply to report the date of settlement.¹⁴ In addition, the proposal would delete Rule 6730(d)(4)(B), which sets forth the three settlement modifiers that will no longer be used in TRACE reporting, delete certain obsolete references, and renumber certain related rules.

Finally, the proposed rule change would make minor technical amendments to Rule 6730(a) through (d).

¹¹ Rule 6730(d)(1).

¹² Previously, FINRA adopted similar provisions for reporting a commission in a transaction in an Asset-Backed Security. See Securities Exchange Act Release No. 61566 (February 22, 2010), 75 FR 9262 (March 1, 2010) (order approving File No. SR-FINRA-2009-065).

¹³ Current Rule 6730(c)(12) will be renumbered as Rule 6730(c)(13). If a trade will not settle on T + 3, the three modifiers that are used to indicate the day the transaction will be settled are “.c” (date of execution), “.nd” (T + 1), or “.sNN” (settlement on a date other than the date of execution, T + 1 or T + 3).

¹⁴ Previously, FINRA adopted a similar requirement in connection with transactions in Asset-Backed Securities. See Securities Exchange Act Release No. 61566 (February 22, 2010), 75 FR 9262 (March 1, 2010) (order approving File No. SR-FINRA-2009-065); Securities Exchange Act Release No. 64364 (April 28, 2011), 76 FR 25385 (May 4, 2011) (order approving File No. SR-FINRA-2011-012).

In the Notice, FINRA stated that it would announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval, and that the effective date would be no later than 180 days following publication of that Regulatory Notice. In its response to comments, FINRA stated that it had several communications with its members about the migration to the MPP.¹⁵ In connection with these communications, FINRA noted that, although subject to Commission approval of the proposed rule change, FINRA anticipates that the MPP migration would occur on February 6, 2012.¹⁶

III. Summary of Comments and FINRA's Response

The Commission received two comments on the proposed rule change.¹⁷

One commenter was generally supportive of the proposed rule change, but raised concerns that FINRA's anticipated implementation date of February 6, 2012 would not provide firms adequate time to develop new systems and processes.¹⁸ According to the commenter, many firms have internal information technology policies that include a year-end "code freeze," which would make it difficult to engage in development or testing for some portion of December 2011 and/or January 2012.¹⁹ The commenter requested that the MPP migration and the proposed rule changes be implemented not earlier than the end of the first quarter of 2012.²⁰

¹⁵ See FINRA Letter at note 3.

¹⁶ See id.

¹⁷ See supra note 4.

¹⁸ See SIFMA Letter.

¹⁹ See id. at 1-2.

²⁰ See id. at 2. The commenter also made minor comments inquiring about: (1) whether both current and future reporting systems protocols could be used simultaneously during the transition; and (2) how certain transactions involving "sinking bonds" should be reported. See id. at 2-3.

In response, FINRA stated that it believed the February 6, 2012 implementation date for the proposed rule change and the MPP migration “provides firms sufficient time to take the steps necessary to make system and procedural changes, test and successfully convert to MPP for reporting corporate bonds and Agency Debt Securities to TRACE.”²¹ In support of its assertion, FINRA noted that MPP is already part of some firms’ interface with TRACE with regard to Asset-Backed Securities reporting.²² Further, FINRA stated that it has provided and will continue to provide the technical specifications that members need to prepare for MPP migration and the implementation of the proposed rule change.²³

FINRA also stated that it will continue to give guidance and assistance to members to prepare for the MPP migration and “will continue to work with members to provide sufficient opportunities to test systems” before implementation.²⁴ Finally, in arguing that the migration of corporate bonds and Agency Debt Securities to MPP should not be delayed, FINRA highlighted the “significant benefits that MPP offers regarding the processing of transactions and the management of important TRACE data.”²⁵ FINRA responded to the commenter’s request that FINRA permit the legacy TRACE system to run in parallel with the FIX protocols and revised CTCI protocols (used in connection with MPP) by explaining that FINRA is not able to support these two reporting formats simultaneously, but that if a firm has a system-related issue during the MPP migration, the firm should contact the appropriate department in FINRA.²⁶

²¹ See FINRA Letter at 3.

²² See id.

²³ See id.

²⁴ Id. at 4.

²⁵ Id.

²⁶ See id. at 5.

FINRA also clarified, in response the commenter's request for guidance regarding the reporting of certain bonds with sinking funds, that "FINRA is engaged in an ongoing review of issues raised by the MPP migration, and will address this and other specific trade reporting questions prior to the MPP migration in its usual and periodic communications with members."²⁷

Another commenter raised issues not germane to the proposed rule change and to which FINRA did not respond.²⁸

IV. Discussion

After carefully considering the proposal, the comments submitted, and FINRA's response to those comments, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.²⁹ In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,³⁰ which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

Transactions in TRACE-Eligible Securities that are Asset-Backed Securities already are processed on the MPP. FINRA now proposes to migrate all other TRACE-Eligible Securities to the MPP and consolidate the reporting of TRACE-Eligible Securities on a single technology platform using common reporting formats. The Commission believes that this change will support more timely and accurate reporting of all transactions in TRACE-Eligible Securities and enhance FINRA's ability to surveil the debt markets for the protection of investors and in

²⁷ See id.

²⁸ See Shatto Letter.

²⁹ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

³⁰ 15 U.S.C. 78o-3(b)(6).

furtherance of the public interest. The Commission notes that the proposed changes being approved today are substantially similar to requirements that already apply to transactions in Asset-Backed Securities that previously have been approved by the Commission.³¹ The Commission believes, therefore, that it is reasonable and consistent with the Act for FINRA to modify the TRACE reporting rules to facilitate MPP migration for corporate bond and Agency Debt Securities in the manner set forth in the proposal.

The Commission does not believe that the commenters raise any issue that would preclude approval of the proposal. The Commission acknowledges the potential for firms covered by these new reporting requirements to incur certain compliance burdens and notes one commenter's objection to FINRA's suggested implementation date of February 6, 2012. The Commission notes that FINRA has indicated a willingness to continue to provide guidance and assistance to market participants throughout the implementation process, including providing ample testing opportunities.

³¹ See Securities Exchange Act Release No. 61566 (February 22, 2010), 75 FR 9262 (March 1, 2010) (order approving File No. SR-FINRA-2009-065); Securities Exchange Act Release No. 64364 (April 28, 2011), 76 FR 25385 (May 4, 2011) (order approving File No. SR-FINRA-2011-012).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³² that the proposed rule change (SR-FINRA-2011-053) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³³

Kevin M. O'Neill
Deputy Secretary

³² 15 U.S.C. 78s(b)(2).

³³ 17 CFR 200.30-3(a)(12).