

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-85713; File No. SR-FINRA-2019-014)

April 24, 2019

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 6730 (Transaction Reporting)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 16, 2019, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA Rule 6730 (Transaction Reporting) to provide members additional time to report to the Transaction Reporting and Compliance Engine (“TRACE”) transactions in U.S. Treasury Securities executed to hedge a primary market transaction, and to adopt a new modifier to identify such transactions.

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

Rule 6730(a)(4) (Reporting Requirements — U.S. Treasury Securities) provides that members must report transactions in U.S. Treasury Securities³ executed on a business day through 5:00 p.m. ET on the same day during TRACE System Hours.⁴ For transactions executed on a business day after 5:00 p.m. ET, members must report the trade no later than the next business day (T+1) during TRACE System Hours, and, if reported on T+1, members must designate the trade “as/of” and include the date of execution. Transactions in U.S. Treasury Securities are reported for regulatory purposes only and are not disseminated. FINRA is proposing to amend Rule 6730 to provide until the end of TRACE System Hours on T+1 for members to report transactions in U.S. Treasury Securities executed to hedge certain primary market transactions in TRACE-Eligible Securities, even where the U.S. Treasury hedge trade occurs before 5:00 p.m. ET, as discussed below.

FINRA understands that, at the request of customers, members often execute U.S. Treasury hedge transactions in connection with primary market transactions that meet the

³ Rule 6710(p) defines a “U.S. Treasury Security” as “a security, other than a savings bond, issued by the U.S. Department of the Treasury to fund the operations of the federal government or to retire such outstanding securities.” The term “U.S. Treasury Security” also includes separate principal and interest components of a U.S. Treasury Security that has been separated pursuant to the Separate Trading of Registered Interest and Principal of Securities (“STRIPS”) program operated by the U.S. Department of Treasury.

⁴ Rule 6710(t) provides that “TRACE System Hours” means the hours the TRACE system is open, which are 8:00:00 a.m. ET through 6:29:59 p.m. ET on a business day, unless otherwise announced by FINRA.

definition of “List or Fixed Offering Price Transaction” or “Takedown Transaction” (i.e., a “P1” transaction).⁵ In such cases, the U.S. Treasury hedge and the P1 transactions are executed in close time proximity because the desired hedge position in the U.S. Treasury Security cannot be determined until the underwriters complete pricing of the new issue underlying the P1 trade and make allocations to customers. Once pricing is complete for the new issue, numerous transactions must be entered and reported to TRACE (i.e., for the U.S. Treasury hedge as well as the related P1 transactions).

Under the current rule, trade reports for U.S. Treasury hedge transactions executed by 5:00 p.m. ET are due on trade date (by the close of TRACE System Hours), whereas all P1 trade reports are due to TRACE on T+1 (by the close of TRACE System Hours).⁶ FINRA understands that this difference in reporting timeframes can present operational challenges for members, particularly where pricing of the debt new issue occurs prior to, but near, 5:00 p.m. ET.

Therefore, FINRA is proposing the instant rule change to align the trade reporting timeframe for

⁵ “List or Fixed Offering Price Transactions” and “Takedown Transactions,” which are identified with the “P1” modifier, generally are primary market sale transactions on the first day of trading of a security: (i) by a sole underwriter, syndicate manager, syndicate member or selling group member at the published or stated list or fixed offering price (or, for Takedown Transactions, at a discount from the published or stated list or fixed offering price) or (ii) in the case of primary market sale transactions effected pursuant to Securities Act Rule 144A, by an initial purchaser, syndicate manager, syndicate member or selling group member at the published or stated fixed offering price (or, for Takedown Transactions, at a discount from the published or stated fixed offering price). See Rule 6710(q) and (r).

⁶ In light of the operational concerns raised by members at the time the P1 transaction reporting requirements were adopted, FINRA allowed members until 6:29:59 p.m. ET on T+1 to report P1 transactions to TRACE. FINRA believed that the additional time was appropriate to address operational concerns and did not negatively impact regulatory surveillance or market transparency because P1 transactions are not subject to dissemination. See Securities Exchange Act Release No. 60726 (September 28, 2009), 74 FR 50991 (October 2, 2009) (Notice of Filing of Amendment No. 2 and Order Approving File No. SR-FINRA- 2009-010); Letter from Sharon Zackula, Associate Vice President and Associate General Counsel, FINRA, to Elizabeth M. Murphy, Secretary, SEC, dated August 26, 2009.

all transactions in U.S. Treasury Securities executed to hedge a P1 trade with the deadline for reporting the related P1 transaction.

Based on a review of P1 transaction data for corporate bond new issuances in 2017, FINRA found that approximately 70% of all P1 trades were executed after 3:00 p.m. ET on the date of issuance. Given that the majority of P1 transactions occur near the end of the day, FINRA believes it is reasonable to provide a consistent reporting timeframe for hedge transactions in U.S. Treasury Securities and related P1 trades (i.e., hedge transactions in U.S. Treasury Securities may be reported until 6:29:59 p.m. ET on T+1). FINRA believes that this additional time may improve member compliance, ease operational concerns and would not impact transparency (because transactions in U.S. Treasury Securities currently are not disseminated).⁷ Thus, FINRA is proposing to amend Rule 6730 to provide members until the close of TRACE System Hours on the next business day (i.e., until 6:29:59 p.m. ET on T+1) to report transactions in U.S. Treasury Securities executed to hedge a P1 transaction. FINRA notes that the proposal would not affect transparency (because transactions in U.S. Treasury Securities currently are not disseminated). FINRA also proposes that members must append a new trade modifier when reporting to TRACE transactions in U.S. Treasury Securities that are executed to hedge a P1 transaction. FINRA believes the modifier would improve FINRA's surveillance by helping FINRA identify the reason a transaction in a U.S. Treasury Security is being reported on T+1 rather than T, would provide useful information to FINRA's audit trail about the purpose of the trade, and provide further insight into the U.S. Treasury Security cash market.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 90

⁷ See Rule 6750(c)(5).

days following Commission approval. The effective date will be no later than 270 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁸ which requires, among other things, that FINRA rules must 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 and Section 15A(b)(9) of the Act,⁹ which requires that FINRA rules not impose any burden on competition that is not necessary or appropriate.

FINRA believes that the proposed rule change to provide members with additional time to trade report hedge transactions in U.S. Treasury Securities may improve member compliance, ease operational concerns, and would not impact transparency (because transactions in U.S. Treasury Securities currently are not disseminated). FINRA believes the proposed new modifier that would identify transactions in U.S. Treasury Securities executed to hedge P1 transactions would improve FINRA's surveillance capabilities by helping FINRA identify the reason a transaction in a U.S. Treasury Security is being reported on T+1 rather than T, would provide useful information to FINRA's audit trail about the purpose of the trade, and provide further insight into the U.S. Treasury Security cash market.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

⁸ 15 U.S.C. 78o-3(b)(6).

⁹ 15 U.S.C. 78o-3(b)(9).

Economic Impacts

FINRA has undertaken an economic impact assessment, as set forth below, to analyze the need for the proposed rulemaking, the regulatory objective of the proposal, the economic baseline of analysis, the anticipated economic impacts, and the alternatives considered.

(a) Regulatory Objective

Institutional investors often hedge P1 transactions with U.S. Treasury Securities. Underwriting syndicate members allocate the P1 transaction among investors, and this may occur prior to, but near, the close of trading on the issue date. Members engaged in the underwriting also acquire the hedging positions in U.S. Treasury Securities on the issue date, but do not know the specific allocation of those securities among clients until the execution of the related P1 transactions. Thus, once pricing is complete for the new issue, possibly hundreds of trades in U.S. Treasury Securities must be entered and reported to TRACE. Members have indicated that this timing difference in the trade reporting requirements can present operational challenges. In response, FINRA proposes to:

- Permit these U.S. Treasury Security hedges to be reported on a T+1 basis; and
- Create a modifier in TRACE for the identification of transactions in U.S. Treasury Securities to hedge a “List or Fixed Offering Price Transaction” or “Takedown Transaction.”

(b) Economic Baseline

When a new issue of a TRACE-Eligible Security comes to market, the underwriting syndicate may provide institutional clients with U.S. Treasury Security hedging services related to the amount of securities allocated to the client. The syndicate desk will allocate the U.S. Treasury Security hedge based on the P1 transactions, which may not be known until late in the

trading day. Members have until the close of the TRACE system on the next business day, T+1, to report P1 transactions, but the secondary market U.S. Treasury trades may be reportable by 6:29:59 p.m. ET on the same day, T. This incongruous reporting timeframe can create an operational burden for the syndicate as approximately 200-300 accounts may be involved in an issuance with respect to P1 transaction and secondary market U.S. Treasury hedge transactions. Based on transaction reports from July 2017 through February 2018, late reporting exceptions represent 0.33% of total transaction reports to TRACE in U.S. Treasury Securities. While FINRA cannot currently determine what percentage of late reporting exceptions are attributed to U.S. Treasury Securities executed to hedge P1 transactions, firms selected for examination of late trade reports attributed nearly 100% of their late transaction reports (typically reported on T+1 rather than T) to U.S. Treasury hedges for new issue TRACE-Eligible Securities. The results from these examinations may not be generalizable to other members as the sample size examined is small.

(c) Economic Impact

Change Reporting Time for U.S. Treasury Hedges to T+1

FINRA believes that permitting U.S. Treasury hedge transactions to be reported with the same deadline as P1 transactions on a T+1 basis will allow for sufficient time for syndicate firms to report hedge transactions without reducing the usefulness of the TRACE data for audit trail purposes. Syndicate firms may benefit, as uniform reporting deadlines would simplify internal operations. This in turn may reduce the syndicate firm's operational burdens relating to maintaining orderly books and records, which may reduce late TRACE reports.

FINRA anticipates that members will experience no material costs from the change in reporting time to T+1 in U.S. Treasury Security hedge transactions. In addition, market

participants will experience no change in transparency from the one-day extension to T+1, because transactions in U.S. Treasury Securities are not currently disseminated. FINRA may incur a cost from this change in reporting time as FINRA would be required to make changes to incorporate the new reporting timeframe into the system logic to ensure that firms are not identified as having reported late until after the end of the new reporting period.

In aggregate, FINRA believes that the benefits of creating a modifier and extending reporting deadlines, as proposed, will outweigh costs of appending the modifier for syndicate firms by simplifying their operations and reducing late trade reports.

Creation of Modifier in TRACE to Identify Certain U.S. Treasury Hedge Transactions

The proposed new modifier that would identify transactions in U.S. Treasury Securities executed to hedge P1 transactions would improve FINRA's surveillance capabilities by helping FINRA identify the reason a transaction in a U.S. Treasury Security is being reported on T+1 rather than T, would provide useful information to FINRA's audit trail about the purpose of the trade, and provide further insight into the U.S. Treasury Security cash market.

FINRA will be required to make system changes and members will need technical changes in order to accommodate the new modifier. This represents a fixed cost to FINRA and its members that report U.S. Treasury Security hedging transactions related to P1 transactions. The variable cost of reporting this new modifier should be minimal to all parties as costs are currently incurred for existing trade reports to TRACE.

(d) Alternatives

No alternatives are under consideration.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

FINRA received an email from SIFMA relating to the need for the proposed rule change.¹⁰ While SIFMA expressed continued support for FINRA's efforts in requiring regulatory reporting of U.S. Treasury Securities to TRACE as a good first step, SIFMA noted that the divergence in the reporting timelines for U.S. Treasury hedge trades related to P1 transactions and the P1 transactions themselves created a significant operational burden for firms. SIFMA also believed that the different reporting timeframes reduced the regulatory value of the data by failing to link the reporting requirements. Therefore, SIFMA recommended that FINRA should (1) align the trade reporting timeframe for U.S. Treasury trades to hedge a P1 transaction with the reporting timeframe for the related P1 transaction, and (2) create an additional modifier to identify all U.S. Treasury hedge trades linked to P1 transactions. The instant proposal addresses these concerns. As stated above, FINRA believes that the proposed rule change to provide members with additional time to trade report P1 hedge transactions in U.S. Treasury Securities may improve member compliance, ease operational concerns, and would not impact transparency because transactions in U.S. Treasury Securities currently are not disseminated.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

¹⁰ E-mail from Robert Toomey, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (SIFMA), to Chris Stone & Justin Tubiolo, FINRA, dated June 13, 2018, 1.24 PM.

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2019-014 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2019-014. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F

Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2019-014, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹¹

Eduardo A. Aleman
Deputy Secretary

¹¹ 17 CFR 200.30-3(a)(12).