

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59519; File No. SR-FINRA-2009-004)

March 5, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change To Amend the Definition of TRACE-Eligible Security to Include Securities Eligible for Public Sale and Additional Securities That Are Restricted Securities

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 February 11, 2009, the Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) 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 6710(a), the definition of “TRACE-eligible security,” to broaden the definition by deleting (i) the requirement that a debt security be registered under the Securities Act of 1933 (“Securities Act”);³ and (ii) with respect to “restricted securities” as that term is defined in Securities Act Rule 144(a)(3),⁴ the requirement

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 77a et seq.

⁴ 17 C.F.R. 230.144(a)(3).

that such securities be issued pursuant to Securities Act Section 4(2)⁵ prior to being resold under Securities Act Rule 144A.⁶

The text of the proposed rule change is available on FINRA's Web site 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 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 Statutory Basis for, the Proposed Rule Change

1. Purpose

FINRA proposes to amend Rule 6710(a), the definition of "TRACE-eligible security," to eliminate two aspects of the requirement therein that such securities be "(1) registered under the Securities Act; or (2) issued pursuant to Section 4(2) of the Securities Act and purchased or sold pursuant to Securities Act Rule 144A." The proposed rule change eliminates the requirement that a TRACE-eligible security be registered under the Securities Act,⁷ thus including more corporate debt securities, and restates and broadens the provision applicable to "restricted

⁵ 15 U.S.C. 77d(2).

⁶ 17 C.F.R. 230.144A.

⁷ 15 U.S.C. 77a et seq.

securities” as defined in Securities Act Rule 144(a)(3),⁸ to include any “restricted security” sold pursuant to Securities Act Rule 144A.⁹

Debt Securities Eligible for Public Sale

The current definition of “TRACE-eligible security” in Rule 6710(a) was adopted in 2002 and has not been amended. Generally, the definition is sufficiently broad to require the reporting of, and provide price transparency for, a substantial portion of corporate bonds that are eligible for public sale (*i.e.*, they are freely tradable because they are not “restricted securities” as defined in Securities Act Rule 144(a)(3)).¹⁰ However, FINRA has identified several situations

⁸ Securities Act Rule 144(a)(3) (17 C.F.R. 230.144(a)(3)) defines “restricted securities” as:

- (i) Securities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or a chain of transactions not involving any public offering; (ii) Securities acquired from the issuer that are subject to the resale limitations of § 230.502(d) under Regulation D or § 230.701(c); (iii) Securities acquired in a transaction or chain of transactions meeting the requirements of § 230.144A; (iv) Securities acquired from the issuer in a transaction subject to the conditions of Regulation CE (§ 230.1001); (v) . . . ; (vi) Securities acquired in a transaction made under § 230.801 in the same extent and proportion that the securities held by the security holder of the class with respect to which the rights offering was made were, as of the record date for the rights offering, “restricted securities” within the meaning of this paragraph (a)(3); (vii) Securities acquired in a transaction made under § 230.802 to the same extent and proportion that the securities that were tendered or exchanged in the exchange offer or business combination were “restricted securities” within the meaning of this paragraph (a)(3); and (viii) Securities acquired from the issuer in a transaction subject to an exemption under section 4(6) (15 U.S.C. 77d(6)) of the Act.

⁹ 17 C.F.R. 230.144A. The proposed rule change does not affect the exclusions currently in the definition of “TRACE-eligible security,” which are: (i) debt issued by a government-sponsored entity; and (ii) debt that is a mortgage-backed or asset-backed security, a collateralized mortgage obligation, or a money market instrument having a maturity at issuance of one year or less.

¹⁰ 17 C.F.R. 230.144(a)(3).

where corporate debt securities that are eligible for public sale in the secondary market are trading without TRACE price transparency. In many cases, the securities that are not subject to TRACE are “exempted securities” under Section 3 of the Securities Act.¹¹ For example, transactions in corporate debt securities that are issued subject to the jurisdiction and approval of a court of competent jurisdiction in insolvency matters may be eligible for public sale and not reported to TRACE because they are not registered under the Securities Act.¹² In addition, among others, debt securities issued as part of an issuer exchange offer effected pursuant to Securities Act Section 3(a)(9)¹³ and those issued by a bank or other financial institutions under Securities Act Section 3(a)(2)¹⁴ (or another subparagraph of the section) generally are not subject to TRACE reporting and dissemination for this reason.

FINRA proposes to amend Rule 6710(a) to remove the unnecessary limitation on the scope of the definition of TRACE-eligible security by deleting the phrase “(1) registered under the Securities Act” from the definition. Eliminating the registration requirement will permit TRACE to capture transaction information for all debt securities that are eligible for public sale

¹¹ 15 U.S.C. 77c.

¹² 15 U.S.C. 77a *et seq.* If an insolvent corporation is reorganized under Chapter 11 of the U.S. Bankruptcy Code, frequently new debt securities are issued. The issuance is subject to the approval of the trustee and the securities are not required to be registered under the Securities Act. *See, e.g.,* U.S. Bankruptcy Code, 11 U.S.C. 101 *et seq.*

¹³ 15 U.S.C. 77c(a)(9). For example, an issuer may exchange an issue of debt securities that are registered under the Securities Act (and subject to both TRACE reporting and dissemination) for a new security that is not registered in reliance upon Securities Act Section 3(a)(9) (15 U.S.C. 77c(a)(9)), which permits such exchanges without registration of the new security. Although the exchanged security was TRACE-eligible, the new security is not because it is not registered as required in Rule 6710(a).

¹⁴ 15 U.S.C. 77c(a)(2).

(and that otherwise meet the standards for TRACE eligibility).¹⁵ FINRA will increase price transparency in such corporate bonds, which FINRA believes is important because many securities that are not registered but are eligible for public sale are being purchased and sold by all market participants, including retail investors. Further, FINRA's obligation to conduct surveillance in the corporate bond market is not limited to transactions in securities that are registered under the Securities Act.¹⁶ Thus, transactions in corporate bonds that are eligible for public sale (and that otherwise meet the standards for TRACE eligibility) will be included in the audit trail to enhance the surveillance of the corporate bond market.¹⁷ In this regard, FINRA's transaction reporting rules apply generally to any equity security that is eligible for public sale and do not consider registration as a factor. FINRA believes that including debt securities that are eligible for public sale as TRACE-eligible securities is vital to its mandate to regulate the market to promote market integrity and to protect investors.

Rule 144A Transactions

The current definition of TRACE-eligible security requires transaction reporting for some but not all of the large market in corporate debt securities that are "restricted securities," as

¹⁵ To be a TRACE-eligible security, a security must also be U.S. dollar denominated, depository eligible and issued by a U.S. and/or foreign private issuer. The credit rating (or lack of a rating) of a security does not impact TRACE eligibility.

¹⁶ 15 U.S.C. 77a et seq.

¹⁷ FINRA is aware that as a result of these amendments certain "TRACE-eligible securities" may not be subject to the notice and informational requirements of Rule 6760, and as a result initially may not be included in the TRACE Issue Master. As noted in FINRA's Trade Reporting Notice, dated February 22, 2008, if a firm has a reporting obligation under Rule 6730 in a TRACE-eligible security that is not included in the TRACE Issue Master, the firm must notify FINRA immediately and provide the CUSIP and other information necessary for FINRA to update the TRACE Issue Master and enable the firm to promptly report the transaction to TRACE and comply with its obligations under Rule 6730.

defined in Securities Act Rule 144(a)(3),¹⁸ sold to “qualified institutional buyers” (“QIBs”), as defined in Securities Act Rule 144A(a)(1),¹⁹ in transactions effected pursuant to Rule 144A (“Rule 144A transactions”).²⁰ Although FINRA believes that a significant number of “restricted securities” that are sold in Rule 144A²¹ transactions are preceded by an offering that is exempt under Securities Act Section 4(2),²² the limitation in the definition excludes other Rule 144A²³ transactions that should be included in the TRACE audit trail.

FINRA proposes to amend Rule 6710(a) to eliminate the requirement regarding Securities Act Section 4(2)²⁴ in the defined term, TRACE-eligible security. The proposed amendment would include as TRACE eligible a “‘restricted security’ as defined in Securities Act Rule 144(a)(3)”²⁵ if it is “sold pursuant to Securities Act Rule 144A.”²⁶

FINRA believes that there is no compelling reason to exclude corporate debt securities sold in a Rule 144A²⁷ transaction from the definition of TRACE-eligible security simply because such corporate debt securities are issued or offered under other exemptive provisions of the Securities Act.²⁸ For example, in a global offering, some debt securities may be issued as part of

¹⁸ 17 C.F.R. 230.144(a)(3).

¹⁹ 17 C.F.R. 230.144A(a)(1).

²⁰ 17 C.F.R. 230.144A.

²¹ 17 C.F.R. 230.144A.

²² 15 U.S.C. 77d(2).

²³ 17 C.F.R. 230.144A.

²⁴ 15 U.S.C. 77d(2).

²⁵ 17 C.F.R. 230.144(a)(3).

²⁶ 17 C.F.R.230.144A.

²⁷ 17 C.F.R. 230.144A.

²⁸ 15 U.S.C. 77a et seq.

a foreign tranche pursuant to Regulation S.²⁹ Under the proposed amendment, U.S. resales of securities from that tranche effected as Rule 144A³⁰ transactions would be required to be reported to TRACE. The proposed amendment regarding Rule 144A³¹ transactions will allow FINRA to obtain a more complete audit trail of Rule 144A³² transactions in corporate bonds. This additional transaction data will enhance the regulatory surveillance of the corporate bond market as a whole.³³

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 30 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,³⁴ 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. FINRA believes that the proposed rule change will provide FINRA with heightened capabilities to regulate and conduct surveillance in the corporate debt securities markets, enhance market transparency and

²⁹ 17 C.F.R. 230.901-905.

³⁰ 17 C.F.R. 230.144A.

³¹ 17 C.F.R. 230.144A.

³² 17 C.F.R. 230.144A.

³³ Currently, as provided in Rule 6750, FINRA does not disseminate Securities Act Rule 144A transactions, and FINRA does not propose to amend Rule 6750. See e-mail from Sharon Zackula, Associate Vice President and Associate General Counsel, FINRA, to Geoffrey Pemble, Special Counsel, Division of Trading and Markets, Commission, dated March 4, 2009.

³⁴ 15 U.S.C. 78o-3(b)(6).

protect investors and other market participants by including in TRACE certain corporate debt securities that currently are traded in the same markets in which TRACE-eligible securities are traded by the same market participants and investors.

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

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

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

Written comments were neither solicited nor received.

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

Within 35 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:

(A) by order approve 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-2009-004 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-FINRA-2009-004. 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 Web site (<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 inspection and copying 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; the Commission does not edit personal identifying information from submissions. You should submit only information

that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2008-004 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.³⁵

Florence E. Harmon
Deputy Secretary

³⁵ 17 CFR 200.30-3(a)(12).