

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64706; File No. SR-FINRA-2011-027)

June 20, 2011

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Amend FINRA Trade Reporting Rules Relating to OTC Transactions in Equity Securities that are Part of a Distribution and Transfers of Equity Securities to Create or Redeem Instruments such as ADRs and ETFs

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 June 9, 2011, 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 Rules 6282, 6380A, 6380B and 6622 relating to trade reporting over-the-counter (“OTC”) transactions in equity securities to (1) clarify the existing exception for transactions that are part of a distribution of securities and impose certain notice requirements on members relying on the exception for transactions that are part of an “unregistered secondary distribution”; and (2) expressly exclude from the trade reporting requirements transfers of equity securities for the purpose of creating or redeeming instruments such as American Depositary Receipts (“ADRs”) and exchange-traded funds (“ETFs”).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

Background

Under FINRA trade reporting rules, members are required to report OTC transactions in equity securities to FINRA unless they fall within an express exception. As a general matter, when members report OTC trades, FINRA facilitates the public dissemination of the trade information and/or assesses regulatory transaction fees under Section 3 of Schedule A to the FINRA By-Laws ("Section 3")³ and the Trading Activity Fee ("TAF").⁴ Under FINRA trade

³ Pursuant to Section 31 of the Act, FINRA and the national securities exchanges are required to pay transaction fees and assessments to the SEC that are designed to recover the costs related to the government's supervision and regulation of the securities markets and securities professionals. FINRA obtains its Section 31 fees and assessments from its membership in accordance with Section 3.

⁴ The TAF is one of the member regulatory fees FINRA uses to fund its member regulation activities, market regulation activities, financial monitoring and policymaking, rulemaking and enforcement activities. Among others, the TAF is assessed for the sale of all exchange registered securities wherever executed and OTC equity securities. See

reporting rules, certain transactions and transfers are not reported to FINRA at all (e.g., trades executed and reported through an exchange and transfers made pursuant to an asset purchase agreement that has been approved by a bankruptcy court), while other transactions must be reported to FINRA for regulatory transaction fee assessment purposes only (e.g., away from the market sales and transfers in connection with certain corporate control transactions).⁵ Members must have policies and procedures and internal controls in place to determine whether a transaction qualifies for an exception under the rules.

Transactions that are part of a securities distribution

FINRA rules contain an exception from the trade reporting requirements for transactions that are effected in connection with a distribution of securities, specifically:

transactions that are part of a primary distribution by an issuer or of a registered secondary distribution (other than “shelf distributions”) or of an unregistered secondary distribution.⁶

Thus, transactions that are part of a distribution (other than a secondary shelf distribution) are not reported to FINRA or publicly disseminated, and they are not assessed regulatory transaction fees under Section 3 or the TAF. This exception was adopted to align the FINRA trade reporting requirements with the Consolidated Tape Association and the Nasdaq Unlisted Trading Privileges plans, which expressly identify transactions that are not to be reported to the tape.⁷

FINRA By-Laws, Schedule A, § 1(b)(2).

⁵ See Rules 6282(i) (Alternative Display Facility), 6380A(e) (FINRA/Nasdaq Trade Reporting Facility), 6380B(e) (FINRA/NYSE Trade Reporting Facility) and 6622(e) (OTC Reporting Facility).

⁶ See Rules 6282(i)(1)(A), 6380A(e)(1)(A), 6380B(e)(1)(A) and 6622(e)(1)(A).

⁷ See, e.g., Notice to Members 75-42 (June 1975).

FINRA is proposing to amend its rules⁸ to clarify that for purposes of this trade reporting exception, “distribution” has the meaning set forth under SEC Regulation M.⁹ A “distribution” is defined under Rule 100 of Regulation M as “an offering of securities, whether or not subject to registration under the Securities Act, that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods.”¹⁰

In addition, FINRA is proposing to adopt Supplementary Material in Rules 6282, 6380A, 6380B and 6622 that is specifically applicable to the trade reporting exception for transactions that are part of an “unregistered secondary distribution.” Pursuant to the proposed Supplementary Material, members that would otherwise have the trade reporting obligation under FINRA rules¹¹ must provide notice to FINRA that they are relying on this exception. The member also must provide the following information to FINRA for each transaction that is part of the unregistered secondary distribution and not trade reported: security name and symbol, execution date, execution time, number of shares, trade price and parties to the trade. Such notice and information must be provided no later than three (3) business days following trade date. If the trade executions will occur over multiple days, then initial notice and available information must be provided no later than three (3) business days following the first trade date and final notice and information must be provided no later than three (3) business days following the last trade date.

⁸ See Rules 6282(i)(1)(A), 6380A(e)(1)(A), 6380B(e)(1)(A) and 6622(e)(1)(A).

⁹ 17 CFR 242.100–105.

¹⁰ 17 CFR 242.100.

¹¹ In transactions between members, the “executing party,” as defined by rule, is required to report the trade, and in transactions between a member and a non-member or customer, the member is required to report. See Rules 6282(b); 6380A(b) and 7230A(c); 6380B(b) and 7230B(c); and 6622(b) and 7330(c).

The proposed Supplementary Material also requires that the member retain records sufficient to document the basis for relying on this trade reporting exception, including but not limited to, the basis for determining that the transactions are part of an unregistered secondary distribution, as defined under Rule 100 of Regulation M. In other words, members must be able to demonstrate that the “magnitude of the offering” and “special selling efforts” criteria under Regulation M have been satisfied. The mere assertion that the order was large sized or a block or that execution of the order was “worked” by a member will usually not by itself be sufficient. Additionally, members must be able to provide evidence of compliance with any applicable notification requirements under FINRA Rule 5190. Rule 5190 imposes certain notice requirements on members participating in distributions of listed and unlisted securities and is designed to ensure that FINRA receives pertinent distribution-related information from its members in a timely fashion to facilitate its Regulation M compliance program. Thus, if a member is relying on this exception from the trade reporting requirements, FINRA would expect to see that the requisite notice under Rule 5190 also has been provided.¹²

FINRA is reiterating that the proposed rule change imposes on members a notice requirement only and not a trade reporting requirement. Accordingly, as is the case today, these transactions will not be trade reported (i.e., through the Alternative Display Facility, a Trade Reporting Facility or the OTC Reporting Facility), nor will they be disseminated to the public. In addition, as is the case today, these transactions will not be assessed regulatory transaction fees under Section 3 or the TAF.

¹² FINRA notes that the proposed notice requirement is separate and distinct from the Regulation M-related notice requirements under Rule 5190. Accordingly, providing notice under the trade reporting rules does not relieve a member of any obligations it may have under Rule 5190, nor does it impact the timing of any notice required under Rule 5190.

FINRA believes that the proposed rule change is necessary to ensure that members interpret this trade reporting exception correctly and report all transactions that are reportable under FINRA rules. For example, under current rules, large block trades (even those at a significant discount from the current market price) must be reported to FINRA for tape dissemination purposes and are assessed regulatory transaction fees under Section 3 and the TAF. The proposed rule change clarifies that the trade reporting exception does not apply to block trades, unless they otherwise meet the definition of distribution under Regulation M.

Transfers of equity securities to create or redeem instruments such as ADRs and ETFs

FINRA also is proposing to amend its rules¹³ to expressly exclude from the trade reporting requirements any transfer of equity securities for the sole purpose of creating or redeeming an instrument that evidences ownership of or otherwise tracks the underlying securities transferred. Such transfers are not considered OTC transactions for purposes of the trade reporting rules and thus are not reportable events.

The proposed rule change codifies current guidance and practice in this area. For example, FINRA has previously stated that the conversion of foreign ordinary shares into ADRs (or vice versa) at a bank depository is not a trade reportable event.¹⁴ Similarly, when a financial institution or “authorized participant” deposits with an ETF a basket of securities (or other assets) and receives the ETF creation unit in return, these are not trade reportable events.¹⁵ Because the transfer of equity securities to create or redeem instruments such as ADRs and ETFs

¹³ See Rules 6282(i)(1), 6380A(e)(1), 6380B(e)(1) and 6622(e)(1).

¹⁴ See Notice to Members 07-25 (May 2007).

¹⁵ For a general discussion of ETFs, including the creation of ETFs, see Securities Act Release No. 8901 (March 11, 2008), 73 FR 14618 (March 18, 2008) (Proposed rule relating to exchange-traded funds; File No. S7-07-08).

is not considered an OTC transaction subject to real-time trade reporting and dissemination under FINRA rules, it is not assessed regulatory transaction fees under Section 3 or the TAF.

FINRA notes, however, that purchases and sales of the securities that are to be transferred for the purpose of creating or redeeming instruments such as ADRs and ETFs and subsequent purchases and sales of the instruments in the secondary market are OTC transactions and must be reported to FINRA in accordance with the trade reporting rules.¹⁶ Additionally, purchases and sales of the underlying securities in order to track the performance of an instrument such as an ADR or ETF, without actually creating the instrument, are trade reportable. Such transactions are subject to regulatory transaction fees under Section 3 and the TAF.¹⁷

FINRA is proposing that the proposed rule change will be effective 90 days following the date of 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,¹⁸ 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. FINRA believes that the

¹⁶ FINRA reminds members that with respect to ADR swap transactions (sometimes called “cross-book” transactions), because the ADRs and the ordinary shares are separate securities and are executed in separate transactions, both the ADR and the foreign ordinary share transactions must be reported separately to FINRA for public dissemination, as required by FINRA rules. See Notice to Members 07-25 (May 2007).

¹⁷ FINRA notes that secondary market transactions in instruments such as ADRs and ETFs must be reported in accordance with the rules and guidance that govern the reporting of OTC transactions. For example, members are required by rule to include the date and time of execution in all trade reports submitted to FINRA; the date and time of execution are the date and time when the parties have agreed to all essential terms of the transaction, including trade price and number of shares.

¹⁸ 15 U.S.C. 78q-3(b)(6).

proposed rule change will clarify the interpretation and application of the current exception from the trade reporting requirements for transactions that are part of a distribution and will enhance market transparency by helping to ensure that transactions that are not part of an “unregistered secondary distribution,” such as large block trades, are properly reported. Additionally, FINRA believes that the proposed rule change will clarify members’ obligations with respect to the reporting of transfers of equity securities to create or redeem instruments such as ADRs and ETFs under FINRA trade reporting rules.

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.

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 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:

(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-2011-027 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-2011-027. 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 a.m. and 3 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-2011-027 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.¹⁹

Cathy H. Ahn
Deputy Secretary

¹⁹ 17 CFR 200.30-3(a)(12).