

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-65025; File No. SR-FINRA-2011-027)

August 3, 2011

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a 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

I. Introduction

On June 9, 2011, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend FINRA Rules 6282, 6380A, 6380B and 6622 relating to trade reporting of over-the-counter (“OTC”) transactions in equity securities. The proposed rule change was published for comment in the Federal Register on June 27, 2011.<sup>3</sup> The Commission received no comments on the proposal. This order approves the proposed rule change.

II. Description of the Proposal and Discussion

A. Background

FINRA proposed to amend FINRA Rules 6282, 6380A, 6380B and 6622 (“trade reporting rules”) relating to trade reporting of OTC transactions in equity securities. 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

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 64706 (June 20, 2011), 76 FR 37382 (“Notice”).

and/or assesses regulatory transaction fees under Section 3 of Schedule A to the FINRA By-Laws (“Section 3”) and the Trading Activity Fee (“TAF”). Certain transactions and transfers of securities are not required to be reported to FINRA (e.g., trades executed and reported through an exchange, transfers made pursuant to an asset purchase agreement that has been approved by a bankruptcy court), while other transactions must be reported to FINRA only for the purpose of assessing the regulatory transaction fee (e.g., away from the market sales and transfers in connection with certain corporate control transactions).<sup>4</sup> Members must have policies and procedures and internal controls in place to enable them to determine whether a transaction qualifies for an exception under the rules.

B. Amended Rules

FINRA proposed to amend its trade reporting rules 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. Transactions That Are Part of 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

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<sup>4</sup> See, e.g., Rules 6282(i), 6380A(e), 6380B(e) and 6622(e).

unregistered secondary distribution.<sup>5</sup>

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.<sup>6</sup>

FINRA proposed to amend its trade reporting rules to incorporate by reference the definition of “distribution” set forth in SEC Regulation M for purposes of this exception.<sup>7</sup> 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.”<sup>8</sup>

In addition, FINRA proposed to adopt Supplementary Material in its trade reporting rules that applies specifically to the trade reporting exception for transactions that are part of an “unregistered secondary distribution” which would require members to provide notice to FINRA that they are relying on this exception. Members also would be required to provide FINRA the security name and symbol, execution date, execution time, number of shares, trade price and parties to the trade, for each transaction that is part of the unregistered secondary distribution and not trade reported. Under the proposed rule, members must provide the notice and information no later than three business days following trade date. If the trade executions occur over

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<sup>5</sup> See Rules 6282(i)(1)(A), 6380A(e)(1)(A), 6380B(e)(1)(A) and 6622(e)(1)(A).

<sup>6</sup> FINRA explained that 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 required to be reported to the tape. See, e.g., Notice to Members 75-42 (June 1975).

<sup>7</sup> 17 CFR 242.100–105.

<sup>8</sup> 17 CFR 242.100.

multiple days, then the member would be required to provide initial notice and information available at that time to FINRA no later than three business days following the first trade date and final notice and information no later than three business days following the last trade date.

The proposed Supplementary Material also would require that the member retain records sufficient to document its 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. FINRA explained that members would be required to demonstrate that they have satisfied the “magnitude of the offering” and “special selling efforts” criteria under Regulation M, and stated that the mere assertion that the order was large-sized or a block or that execution of the order was “worked” by a member would usually not by itself be sufficient. FINRA also explained that members must be able to demonstrate that they have complied with the applicable notification requirements in FINRA Rule 5190.<sup>9</sup> The Commission notes that the proposed rule change imposes a notice requirement; it does not impose a trade reporting requirement. As is the case today, under the proposal, 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, would not be trade reported nor would they be disseminated to the public. In addition, these transactions would not be assessed regulatory transaction fees under Section 3 or the TAF.

The Commission believes that this requirement, as well as the modification to provide a definition of “distribution” for use in connection with the exception, should ensure that members apply the trade reporting exception correctly and should help ensure that members report all

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<sup>9</sup> 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 in connection with its Regulation M compliance program.

transactions that are required to be reported. The Commission specifically notes that large block trades must be reported to FINRA for tape dissemination purposes and are assessed regulatory transaction fees under Section 3 and the TAF. The trade reporting exception does not apply to block trades, unless they otherwise meet the definition of distribution under Regulation M.

2. Transfers of Equity Securities to Create or Redeem Instruments  
Such as ADRs and ETFs

FINRA also proposed to amend its trade reporting rules 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. FINRA explained that such transfers are not considered transactions for purposes of the trade reporting rules and thus are not reportable events.<sup>10</sup> FINRA represented that the proposed rule change codifies current guidance and practice in this area. The Commission believes that this codification of current practice will help reduce confusion with regard to what is required to be reported under FINRA's trade reporting requirements and thus reduce reporting errors.

FINRA stated that the proposed rule change will be effective 90 days following the date of Commission approval.

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<sup>10</sup> FINRA explained, 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. FINRA also noted that 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 and that such transactions are subject to regulatory transaction fees under Section 3 and the TAF.

### III. Commission's Findings

After carefully considering the proposed rule change, the Commission finds that it is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association. In particular, the Commission finds that the proposal is consistent with Section 15A(b)(6) of the Act,<sup>11</sup> 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.<sup>12</sup>

The Commission believes that the proposal is reasonably designed to clarify the interpretation and application of the current exception from the trade reporting requirements for transactions that are part of a distribution. The Commission believes that the proposal will: (1) 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; and (2) 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.

In addition, FINRA will receive information regarding transactions that are part of an unregistered secondary distribution which will enhance FINRA’s ability to monitor compliance with the securities laws and rules.

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<sup>11</sup> 15 U.S.C. 78o-3(b)(6).

<sup>12</sup> 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).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (SR-FINRA-2011-027), be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>14</sup>

Elizabeth M. Murphy  
Secretary

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<sup>13</sup> 15 U.S.C. 78s(b)(2).

<sup>14</sup> 17 CFR 200.30-3(a)(12).