

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61979; File No. SR-FINRA-2010-003)

April 23, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, Relating to Trade Reporting of OTC Equity Securities and Restricted Equity Securities

I. Introduction

On January 15, 2010, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission” or “SEC”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change relating to trade reporting of OTC Equity Securities and certain restricted equity securities. On February 5, 2010, FINRA filed Amendment No. 1 to the proposed rule change. The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on February 19, 2010.³ The Commission received no comment letters on the proposed rule change. On March 25, 2010, FINRA filed Amendment No. 2 to the proposed rule change.⁴ Because Amendment No. 2 is technical in nature, the Commission is not publishing it for comment. This order approves the proposed rule change, as modified by Amendment Nos. 1 and 2.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 61510 (February 5, 2010), 75 FR 7530 (“Notice”).

⁴ Amendment No. 2 reflects changes to FINRA Rule 6635 that were made in SR-FINRA-2010-002, which was filed with the Commission for immediate effectiveness on January 14, 2010. See Securities Exchange Act Release No. 61427 (January 27, 2010), 75 FR 5834 (February 4, 2010).

II. Background

In 1990, the SEC adopted Rule 144A (“SEC Rule 144A”) under the Securities Act of 1933⁵ (“Securities Act”) to establish a safe harbor for the private resale of “restricted securities” to “qualified institutional buyers” (“QIBs”).⁶ At the same time, FINRA (formerly known as the National Association of Securities Dealers, Inc. (“NASD”)) created the PORTAL Market to serve as a system for quoting, trading, and reporting trades in certain designated restricted securities that were eligible for resale under SEC Rule 144A (“PORTAL securities”).⁷ In September 2008, the NASDAQ Stock Market (“NASDAQ”) ceased the operation of the PORTAL Market.⁸ NASDAQ explained in its rule filing that it is taking a minority stake in a consortium that will control and operate a new electronic platform for handling transactions in SEC Rule 144A-eligible securities.⁹ In October, 2009, NASDAQ filed a proposed rule change

⁵ 17 CFR 230.144A.

⁶ See Securities Act Release No. 6862 (April 23, 1990), 55 FR 17933 (April 30, 1990). For the purpose of SEC Rule 144A, a QIB is generally defined as any institution acting for its own account, or for the accounts of other QIBs, that in the aggregate owns and invests on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with the institution.

⁷ See Securities Exchange Act Release No. 27956 (April 27, 1990), 55 FR 18781 (May 4, 1990).

⁸ See Securities Exchange Act Release No. 58638 (September 24, 2008), 73 FR 57188 (October 1, 2008). As part of the separation of NASDAQ from FINRA, certain functionality relating to PORTAL, including the qualification and designation of PORTAL securities, became part of NASDAQ’s rules and were eliminated from the NASD rules. See Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006).

⁹ In addition to NASDAQ ceasing operation of the PORTAL Market, the Commission has also approved the deletion of the Depository Trust Company (“DTC”) requirement that a SEC Rule 144A security, other than investment grade securities, be included in an “SRO Rule 144A System” in order to be eligible for DTC’s deposit, book-entry delivery, and other depository services. See Securities Exchange Act Release No. 59384 (February 11,

with the Commission for immediate effectiveness terminating NASDAQ's PORTAL security designation process and removing rules related to the PORTAL Market from its rulebook.¹⁰ As a result, NASDAQ no longer accepts new applications for debt or equity securities seeking PORTAL designation.¹¹

In the instant rule proposal, FINRA has proposed to delete certain PORTAL rules from its rulebook, amend certain other rules to address gaps that elimination of such PORTAL rules would create, amend certain definitions to create consistent use of terminology in FINRA rules, and make certain other clarifying changes.

III. Description of the Proposal

Current FINRA Rule 6610 requires that members report transactions in "OTC Equity Securities" to the OTC Reporting Facility ("ORF").¹² Under the current definitions in Rule 6420, "restricted securities," as defined by SEC Rule 144(a)(3), and securities designated in the PORTAL Market are carved out of the ORF reporting requirement.¹³ Transaction reporting for certain of these securities to the ORF -- specifically, restricted equity securities that are designated for inclusion in the PORTAL Market -- is instead required by FINRA Rule 6633(a).¹⁴

2009), 74 FR 7941 (February 20, 2009). The PORTAL Market was the only "SRO Rule 144A System." Id.

¹⁰ Securities Exchange Act Release No. 60991 (November 12, 2009), 74 FR 60006 (November 19, 2009).

¹¹ See id. NASDAQ noted in the filing that nothing in the proposal was "intended to impact securities previously designated as PORTAL securities or alter any existing regulatory obligation applicable to such securities, including, but not limited to, any trade reporting obligation imposed by any self-regulatory organization." Id.

¹² See FINRA Rule 6610.

¹³ See FINRA Rule 6420 (c) and (d).

¹⁴ See FINRA Rule 6633(a). See also, Notice, supra note 3.

In light of the recent elimination of NASDAQ's PORTAL rules, FINRA has proposed to eliminate certain of its PORTAL rules.¹⁵ However, because FINRA has determined that elimination of the PORTAL rules that govern transaction reporting would create a gap in the transaction reporting requirements for SEC Rule 144A securities, FINRA proposed to amend FINRA Rule 6622, to ensure that all equity securities that are "restricted securities" under Rule 144(a)(3);¹⁶ and that are traded pursuant to SEC Rule 144A, will continue to be reported to the ORF. Under the proposal, transactions in all restricted equity securities effected pursuant to Commission Rule 144A would generally be required to be reported to the ORF no later than 8:00 p.m. Eastern Time without interruption.¹⁷ Transactions in restricted equity securities effected pursuant to Commission Rule 144A and executed between 8:00 p.m. and midnight would be required to be reported the following business day (T+1) by 8:00 p.m.

In addition, FINRA proposed to amend the definition of "OTC Equity Security" in Rule 6420 to delete the reference to securities that "qualify for real-time trade reporting" and, instead, to define the term as any equity security that is not an "NMS stock" as defined by the Commission in Regulation NMS.¹⁸ The proposed rule change also would eliminate the defined

¹⁵ FINRA Rule 6633(a). The proposed rule change is limited in scope to equity securities and would not affect the Trade Reporting and Compliance Engine Service ("TRACE") or the reporting requirements with respect to transactions in debt securities. See Notice supra note 3. In addition to the reporting rules, current FINRA Rule 6635 specifies which FINRA rules are and are not applicable to transactions and business activities relating to PORTAL securities. Under the proposal FINRA will retain FINRA Rule 6635 as FINRA Rule 6630 to maintain the status quo with respect to the application of FINRA rules to those securities designated as PORTAL securities prior to October 26, 2009.

¹⁶ See 17 CFR 230.144.

¹⁷ See Notice supra note 3, explaining that the ORF reporting session deadline is 8:00 p.m.

¹⁸ Rule 600 of Regulation NMS defines "NMS stock" as any NMS security other than an option. "NMS security" is defined as "any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective

term “non-exchange-listed security” from Rule 6420.¹⁹ The effect of these changes is that any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan will be excluded from the definition of “OTC Equity Security” in Rule 6420.

Further, the proposal would amend the ORF rules to address explicitly transactions in OTC Equity Securities that are executed on an exchange. FINRA’s trade reporting rules historically have been limited to only trades executed “otherwise than on an exchange.”²⁰ As explained in the Notice, the FINRA/NASDAQ TRF Rules, the FINRA/NYSE TRF Rules, and the ADF Rules all include an exception from the reporting obligations for transactions reported on or through an exchange.²¹ These rules collectively provide for the submission of trade reports to FINRA for transactions in NMS stocks only if the transaction is executed over-the-counter. FINRA Rule 6622, which governs the submission of transaction reports to the ORF for transactions in OTC Equity Securities, does not include a similar exception for transactions in otherwise eligible securities that are reported on or through an exchange.²² Thus, FINRA

transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.” See 17 CFR 242.600(b)(46), 242.600(b)(47).

¹⁹ FINRA Rule 6440 (Submission of SEA Rule 15c2-11 Information on Non-Exchange-Listed Securities) and NASD Rule 2320(f), which is often referred to as the Three Quote Rule, use the term “non-exchange-listed security.” Because the proposed rule change deletes the term “non-exchange-listed security” from Rule 6420, the proposed rule change also amends FINRA Rule 6440 and NASD Rule 2320(f) to define the term for purposes of those rules. The proposed definition in each rule is identical to the definition as it appeared in FINRA Rule 6420. Consequently, there is no change in the application of either rule as a result of the proposed rule change.

²⁰ See, e.g., FINRA Rule 6100, 6200, and 6300 Series.

²¹ See FINRA Rules 6282(i)(1)(C), 6380A(e)(1)(C), 6380B(e)(1)(C).

²² The ORF Rules do include an exception for transactions in foreign equity securities when the transaction is executed on and reported to a foreign securities exchange or the

proposed to amend Rule 6622 to include an explicit exception for transactions in OTC Equity Securities reported on or through an exchange, and to amend Rule 6420(k) and Rule 6610 to clarify further that transactions in OTC Equity Securities must be reported to the ORF where such transactions are executed otherwise than on or through an exchange.

FINRA also proposed to conform the definition of “OTC equity security” in Rule 7410 of the OATS rules to the proposed definition in Rule 6420 and explained that the proposed change will not result in any change to the scope of securities required to be reported to OATS. FINRA similarly proposed to eliminate the separate definition of “OTC Equity Security” in FINRA Rule 4560 (Short-Interest Reporting),²³ explaining that the proposal would “exclude from the short-interest record keeping and reporting requirements all restricted equity securities, such that equity securities that are currently PORTAL securities would continue to be excepted from the record keeping and reporting requirements as well as any other restricted equity securities.”²⁴

As stated in the Notice, FINRA represented that it 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 30 days following publication of the Regulatory Notice announcing Commission approval.

transaction is executed over-the-counter in a foreign country and is reported to the regulator of securities markets for that country. See FINRA Rule 6622(g).

²³ In Amendment No. 1, FINRA stated as follows: “The proposed rule change eliminates the separate definition of “OTC Equity Security” in FINRA Rule 4560 (Short-Interest Reporting). Currently, the PORTAL Rules carve out PORTAL securities from the record keeping and reporting requirements of Rule 4560. See Rule 6635(d). Consistent with this existing exclusion for PORTAL securities, FINRA is proposing to amend Rule 4560 to exclude from the short-interest record keeping and reporting requirements all restricted equity securities, such that equity securities that are currently PORTAL securities would continue to be excepted from the record keeping and reporting requirements as well as any other restricted equity securities.”

²⁴ See Amendment No. 1.

IV. Discussion and Commission's Findings

The Commission has reviewed carefully the proposed rule change and finds that the proposal is consistent with the Act and the rules and regulations thereunder applicable to a national securities association, including the provisions of Section 15A(b)(6) of the Act,²⁵ which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing transactions in securities, and, in general, to protect investors and the public interest.²⁶

The proposed rule change is intended to address the cessation of the PORTAL market and clarify the scope of the ORF Rules, as well as make conforming changes to other FINRA Rules. The Commission believes that the proposed rule change is reasonably designed to ensure that FINRA will continue to receive important transaction information with respect to securities that are traded over-the-counter. In addition, the Commission believes that the amended definition "OTC Equity Security," the standardization of that definition throughout FINRA rules

²⁵ 15 U.S.C. 78o-3(b)(6).

²⁶ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. See 15 U.S.C. 78c(f).

and FINRA's other proposed changes will close gaps and add clarity with respect to the application of specified FINRA rules to certain securities.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-FINRA-2010-003), as modified by Amendment Nos. 1 and 2, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁷

Florence E. Harmon
Deputy Secretary

²⁷ 17 CFR 200.30-3(a)(12).