

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-75588; File No. SR-FINRA-2015-026)

August 3, 2015

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Require an Indicator When a TRACE Report Does Not Reflect a Commission or Mark-up/Mark-down

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 July 20, 2015, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“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 require an indicator when the TRACE report does not reflect a commission or mark-up/mark-down.

Below is the text of the proposed rule change. Proposed new language is in italics.³

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6000. QUOTATION AND TRANSACTION REPORTING FACILITIES

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6700. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The text of the proposed rule change reflects rule text approved by the SEC in SR-FINRA-2014-050, but which does not become effective until November 2, 2015. See Securities Exchange Act Release No. 74482 (March 11, 2015); 80 FR 13940 (March 17, 2015) (Order Approving File No. SR-FINRA-2014-050).

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6730. Transaction Reporting

(a) through (b) No Change.

(c) Transaction Information To Be Reported

Each TRACE trade report shall contain the following information:

(1) through (10) No Change.

(11) The commission (total dollar amount), if applicable;

(12) through (13) No Change.

(d) Procedures for Reporting Price, Capacity, Volume

(1) Price

For principal transactions, report the price, which must include the mark-up or mark-down. (However, if a price field is not available, report the contract amount and, if applicable, the accrued interest.) For agency transactions, report the price, which must exclude the commission. (However, if a price field is not available, report the contract amount and, if applicable, the accrued interest.) Report the total dollar amount of the commission if one is assessed on the transaction. Notwithstanding the foregoing, a member is not required to include a commission, mark-up or mark-down where one is not assessed on a trade-by-trade basis at the time of the transaction or where the amount is not known at the time the trade report is due. In all cases, a member must use the No Remuneration indicator as provided in paragraph (d)(4)(F) where a trade report does not reflect either a commission, mark-up or mark-down.

(2) through (3) No Change.

(4) Modifiers; Indicators

Members shall append the applicable trade report modifiers or indicators as specified by FINRA to all transaction reports.

(A) through (E) No Change.

(F) No Remuneration Indicator

Where a trade report does not reflect either a commission, mark-up or mark-down, select the No Remuneration indicator.

(e) through (f) No Change.

••• Supplementary Material: -----

.01 through .02 No Change.

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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 Rule 6730 (Transaction Reporting) sets forth the requirements applicable to members reporting transactions in TRACE-Eligible Securities,⁴ and provides the specific items

⁴ Rule 6710 generally defines a "TRACE-Eligible Security" as: (1) a debt security that is U.S. dollar-denominated and issued by a U.S. or foreign private issuer (and, if a "restricted security" as defined in Securities Act Rule 144(a)(3), sold pursuant to

of information that must be included in a TRACE trade report. Among other things, Rules 6730(c) and (d) require that firms report the commission (total dollar amount) separately on the TRACE trade report for agency transactions. FINRA then combines the dollar amount that is reported as the commission with the amount that is reported in the price field, and disseminates to the market this aggregate amount as the transaction's price. For principal transactions, Rule 6730(d)(1) provides that firms must report a price that includes the mark-up/mark-down, and FINRA disseminates this price to the market. The goal of these reporting requirements is to enable FINRA to provide investors and market participants with pricing information that better reflects comparable prices for principal and agency trades in a TRACE-Eligible Security.

FINRA is proposing that firms identify those transactions for which a commission or mark-up/mark-down is not reflected in a TRACE trade report because the firm does not charge or does not know the amount of the commission or mark-up/mark-down at the time of TRACE reporting. For example, some firms may assess a charge that is not transaction-based, such as in the case of a "fee-based account" where remuneration is based upon assets under management (and individual commissions or mark-ups/mark-downs are not charged).⁵ As a result, when the price of the transaction is publicly disseminated, there currently is no indication to the public that the price is not inclusive of a commission or mark-up/mark-down.

Securities Act Rule 144A); or (2) a debt security that is U.S. dollar-denominated and issued or guaranteed by an "Agency" as defined in Rule 6710(k) or a "Government-Sponsored Enterprise" as defined in Rule 6710(n). Most transactions reported to TRACE are publicly disseminated immediately upon receipt of a transaction report.

⁵ Another example of a fee structure that is not transaction-based is where an ATS charges subscribers a fixed fee for unlimited trading each month. The ATS could then execute trades either as principal, by acting as an intermediary in all subscriber trades, or on an agency basis, by providing the system through which subscribers' trades are executed.

By way of further example, some firms charge a commission or mark-up/mark-down, but may not know the exact amount of that commission or mark-up/mark-down at the time the TRACE transaction report is required to be submitted because of their remuneration structure (e.g., a firm may not calculate a mark-up for a transaction on a trade-by-trade basis, but will, nonetheless, ultimately assess transaction remuneration pursuant to a monthly volume-based schedule). As a result, the firm will not know the commission or mark-up/mark-down at the time of TRACE reporting.⁶

FINRA therefore proposes to require firms to identify such trades, and FINRA will flag these disseminated transactions as not being inclusive of remuneration.⁷ As is the case now, the disseminated TRACE feed will not explicitly distinguish between agency and principal transactions, and the no-remuneration flag will apply to both principal and agency transactions. FINRA believes that pricing information disseminated today may be incomplete and, in some cases, misleading given that disseminated prices on transactions that do not include remuneration are not distinguished from transactions that do include a commission or mark-up/mark-down. FINRA believes that the proposal will provide more meaningful pricing transparency through

⁶ As a practical matter, it is difficult for firms to comply with the current TRACE rules for these types of volume-based mark-up/mark-down arrangements, since firms are unable to report accurately all the required information related to the transaction on a timely basis and would need to submit a cancel and replace to update the pricing information. In some cases, this information may not be known until the end of the month. Under the proposal, members would not be required to reflect a mark-up/mark-down or commission in a TRACE trade report where the charge is not known at the time of the transaction, but would be required to report the proposed identifier.

⁷ In addition, if a firm does not charge any remuneration associated with the trade (in any form), they would be required to identify the trade as one for which no remuneration was assessed to the transaction. FINRA notes that the MSRB has similarly proposed to require members to report an indicator that would be disseminated to identify transactions that do not include a dealer compensation component. See MSRB Regulatory Notice 2014-14 (August 13, 2014).

TRACE by identifying those transactions where no commission or mark-up/mark-down was charged or known at the time of TRACE reporting, while not inhibiting possible firm remuneration arrangements, particularly if these arrangements benefit customers.

FINRA also believes that this proposal will enhance its regulatory audit trail and surveillance patterns. With this additional level of detail, surveillance patterns should yield fewer false positives regarding mark-up and best execution surveillance, reduce regulatory inquiries, and provide greater focus for FINRA's regulatory efforts. For example, without this designation, FINRA's surveillance patterns for best execution may generate an alert for transactions whose prices reflect a commission or a mark-up as being outliers compared to transactions whose prices do not reflect a charge.

FINRA discussed the proposal with advisory committees in developing its approach. These parties were supportive of the proposal, believing that it would improve the value of information for TRACE-Eligible Securities that is submitted to FINRA, and, by extension, to investors and market participants. With regards to effort involved in affecting the change, committee members did not express any particular concerns with respect to the operational impacts or costs of the proposal. However, as to facilitate planning and scheduling, firms specifically requested that sufficient lead-time be provided when determining the effective date of the rule. Further discussions with firms that would be directly impacted by the proposal also indicated that the proposal would be beneficial to market participants, and that the necessary technological changes would not be unduly burdensome given an adequate implementation timeframe.

If the Commission approves the proposed rule change, the proposed rule change shall be effective upon Commission approval. The implementation date will be May 23, 2016.

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 this proposal is consistent with the Act because the additional identifier will enhance its regulatory audit trail and surveillance patterns. With this additional level of detail, surveillance patterns should yield fewer false positives regarding mark-up and best execution surveillance, reduce regulatory inquiries, and provide greater focus for FINRA's regulatory efforts. For example, without this designation, FINRA's surveillance patterns for best execution may generate an alert for transactions whose prices reflect a commission or a mark-up as being outliers compared to transactions whose prices do not reflect a charge. FINRA also believes that the proposal will improve the information value of TRACE reports as investors and other market participants will receive additional information regarding pricing information for TRACE-Eligible Securities. Finally, FINRA believes that this proposal would permit firms additional flexibility in structuring their fee arrangements with investors, which may provide cost benefits to such investors.

⁸ 15 U.S.C. 78o-3(b)(6).

⁹ 15 U.S.C. 78o-3(b)(9).

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. FINRA notes that the proposed rule change is designed to assist FINRA in meeting its regulatory obligations by enhancing its audit trail and surveillance patterns. While this proposal will require members to meet the proposed reporting obligation, ensure that they can properly ascertain transactions that require the new identifier, and update their compliance procedures and reporting protocols accordingly, FINRA notes that this proposal will apply uniformly to firms that report transactions in TRACE-Eligible Securities. FINRA also believes that this proposal will allow firms more flexibility in designing their fee structures.

As set forth above, FINRA has undertaken an economic impact assessment to further analyze, among other things, the need for the proposed rulemaking and the economic impacts of the proposed rulemaking. As discussed above, FINRA does not believe that the compliance costs associated with the proposal would be unduly burdensome given an adequate implementation timeframe.

Economic Impact Assessment

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

(a) Need for the Rule

FINRA believes that pricing information disseminated today may be incomplete and, in some cases, misleading given that disseminated prices on transactions that do not include

remuneration are not distinguished from transactions that do include a commission or mark-up/mark-down.

(b) Regulatory Objective

FINRA believes that the proposal will provide more meaningful pricing transparency through TRACE by identifying those transactions where no commission or mark-up/mark-down was charged or known at the time of TRACE reporting, while not inhibiting possible firm fee remuneration arrangements, particularly if these fee arrangements benefit customers. FINRA also believes that the additional identifier will enhance its regulatory audit trail and surveillance patterns, because it will require the firm to affirmatively report this information related to the commission or mark-up/mark-down and will enable FINRA to more efficiently separate out no-remuneration trades for purposes of surveillance, analysis, and dissemination.

(c) Economic Baseline

The staff analyzed corporate bond transactions reported to TRACE in Q3 2013.¹⁰ Transactions where the broker-dealer acts in an agency capacity are reported to TRACE with a separate field for commission. FINRA can therefore accurately identify agency-capacity transactions reported without a commission.¹¹ In contrast, for transactions where the broker-

¹⁰ For purposes of this analysis, FINRA used data reported to TRACE (not the TRACE-disseminated data). Although the TRACE-disseminated data includes a flag (Y or blank) that identifies whether a commission is included in the disseminated price, the data does not specify in what capacity the dealer acted in the transaction. As such, an agency transaction without a commission, e.g., the commission flag is blank, would look the same on the TRACE-disseminated data as a principal transaction with or without a mark-up/mark-down.

Corporate bond transactions represented approximately 73% of all transactions reported to TRACE in 2013.

¹¹ Although FINRA is currently able to accurately identify agency-capacity transactions that are reported without a commission, this process requires FINRA to match trades where the commission field is blank with trades where the dealer acted as agent. With the no-

dealer acts in a principal capacity, the mark-up or mark-down is included in the reported price. It was necessary for the staff to pair a broker-dealer's buy and sell principal-capacity transactions of equal sizes in a given security on a given day to estimate the mark-ups or mark-downs on the customer transactions.¹²

During Q3 2013, the daily average number of agency-capacity transactions in corporate bonds was 9,100.¹³ Approximately 55% of agency-capacity transactions in corporate bonds were customer transactions. Based on the data, the staff estimated that approximately 85% of Investment Grade corporate bond customer transactions where the broker-dealer acted in an agency capacity were reported without a commission. For Non-Investment Grade and unrated corporate bonds, the proportions were 74% and 92%, respectively. Such transactions may have been executed for fee-based accounts or other accounts where firm remuneration was not determined on a per-transaction basis. For the agency-capacity customer transactions reported with commissions, the table below summarizes the average commission charged for agency-capacity customer buy and customer sell transactions in Investment Grade, Non-Investment Grade and Unrated securities over the quarter.

remuneration flag, the firm will be required to affirmatively report this information related to the commission or mark-up/mark-down, and FINRA will be able to more efficiently identify such trades.

¹² FINRA recognizes that any pairing methodology adopted requires assumptions as part of that methodology. Further, there is not a unique set of assumptions that reasonable parties might all choose to adopt if they were to go through a similar exercise. As a result, FINRA provides results of this methodology as part of the baseline in order to inform the discussion of potential regulatory impacts.

¹³ This excludes List or Fixed Offering Price Transactions, as defined in FINRA Rule 6710(q), and Takedown Transactions as defined in FINRA Rule 6710(r).

	Average Commission (in basis points)		
	Investment Grade	Non-Investment Grade	Unrated
Customer Buy	18	21	21
Customer Sell	21	20	32

During Q3 2013, the daily average number of principal-capacity transactions in corporate bonds was just under 48,000.¹⁴ Approximately 45% of principal-capacity transactions in corporate bonds were customer transactions. Using the previously described pairing methodology, the staff estimated that 19% of these customer transactions were reported to have been executed without a mark-up or mark-down. For the principal-capacity customer transactions estimated to include mark-ups or mark-downs, the table below summarizes the estimated average remuneration charged for principal-capacity customer buy and customer sell transactions in Investment Grade, Non-Investment Grade and Unrated securities in the quarter.

	Average Mark-up/Mark-down (in basis points)		
	Investment Grade	Non-Investment Grade	Unrated
Customer Buy	75	66	73
Customer Sell	50	78	60

(d) Economic Impacts

FINRA believes that the proposal will enable market participants, including investors relying on TRACE for valuation information, to better understand the prevailing market prices by being able to distinguish between transactions that include remuneration and those that do not. As discussed above, FINRA further believes that the additional identifier will enhance its regulatory audit trail and surveillance patterns. With this additional level of detail, surveillance patterns should yield fewer false positives regarding mark-up and best execution surveillance,

¹⁴ This excludes List or Fixed Offering Price Transactions, as defined in FINRA Rule 6710(q), and Takedown Transactions as defined in FINRA Rule 6710(r).

reduce regulatory inquiries, and provide greater focus for FINRA's regulatory efforts. For example, without this designation, FINRA's surveillance patterns for best execution may generate an alert for transactions whose prices reflect a commission or a mark-up as being outliers compared to transactions whose prices do not reflect a charge.

The proposal will require member firms to meet the proposed reporting obligation, ensure that they can properly ascertain transactions that require the new identifier, and update their compliance procedures and reporting protocols accordingly. Member firms would also need to make technological changes to their systems to include the identifier. Based on discussions with advisory committees and member firms, FINRA does not believe that the compliance costs associated with the proposal would be unduly burdensome given an adequate implementation timeframe.

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-2015-026 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-2015-026. 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 the 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-2015-026 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.¹⁵

Robert W. Errett
Deputy Secretary

¹⁵ 17 CFR 200.30-3(a)(12).