

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61510; File No. SR-FINRA-2010-003)

February 5, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Relating to Trade Reporting of OTC Equity Securities and Restricted Equity 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 January 15, 2010, 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. On February 5, 2010, FINRA filed Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as modified by Amendment No. 1, from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend the FINRA OTC Reporting Facility (“ORF”) Rules and the PORTAL Rules (FINRA Rule 6630 Series) regarding the reporting requirements for restricted equity securities; update the definition of “OTC Equity Security;” and clarify member reporting obligations with respect to certain trades reported on or through an exchange.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 clarifies the proposed revision to FINRA Rule 4560. See infra note 20.

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

The proposed rule change includes several amendments to the reporting provisions regarding the ORF. In general, the proposed rule change amends the definition of "OTC Equity Security" in the FINRA trade reporting rules to address the cessation of the PORTAL Market and clarifies the scope of the ORF rules. The proposed rule change also makes conforming changes to other FINRA rules, including the Order Audit Trail System ("OATS") rules.

(a) Amendments to the ORF Rules

In 1990, the SEC adopted Rule 144A ("SEC Rule 144A") under the Securities Act of 1933⁴ ("Securities Act") to establish a safe harbor for the private resale of "restricted securities"

⁴ 17 CFR 230.144A.

to “qualified institutional buyers” (“QIBs”).⁵ At the same time, FINRA (then 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”).⁶ In September 2008, the NASDAQ Stock Market (“NASDAQ”) ceased the operation of the PORTAL Market.⁷ NASDAQ explained in the 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.⁸ On October 26, 2009, NASDAQ filed a proposed rule change with the Commission for immediate effectiveness terminating NASDAQ’s PORTAL security designation process and removing rules related to the PORTAL

⁵ 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.

⁶ See Securities Exchange Act Release No. 27956 (April 27, 1990), 55 FR 18781 (May 4, 1990).

⁷ 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 FINRA rules. See Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006).

⁸ 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, 2009), 74 FR 7941 (February 20, 2009). The PORTAL Market was the only “SRO Rule 144A System.” Id.

Market from its rulebook.⁹ As a result, NASDAQ no longer accepts new applications for debt or equity securities seeking PORTAL designation.¹⁰

FINRA's transaction reporting rules for restricted equity securities are currently tied to whether the security is designated for inclusion in the PORTAL Market. Specifically, FINRA's general transaction reporting rules for over-the-counter equity securities specifically exclude restricted securities and PORTAL securities from the reporting requirements.¹¹ FINRA's PORTAL rules (FINRA Rule 6630 Series) require that transactions in PORTAL equity securities be reported to the ORF no later than 6:30 p.m. Eastern Time.¹² However, this requirement applies only to those restricted equity securities that are designated for inclusion in the PORTAL Market. Thus, the cessation of the operation of the PORTAL Market and the designation of securities as PORTAL securities creates a gap in FINRA's transaction reporting requirements for restricted equity securities that are traded pursuant to SEC Rule 144A.

⁹ Securities Exchange Act Release No. 60991 (November 12, 2009), 74 FR 60006 (November 19, 2009).

¹⁰ 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.

¹¹ See FINRA Rule 6400 Series.

¹² 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. With respect to PORTAL securities that are debt securities, FINRA Rule 6633(b) currently requires members to report secondary market transactions to TRACE in accordance with the FINRA Rule 6700 Series. Thus, under current FINRA rules, reporting obligations for debt securities are set forth in the TRACE rules rather than the PORTAL rules. The proposed rule change deletes FINRA Rule 6633(b); however, the deletion of this provision does not affect the reporting obligations with respect to transactions in any debt security.

FINRA believes it is appropriate to continue to receive information regarding transactions in restricted equity securities traded pursuant to SEC Rule 144A for audit trail and other regulatory purposes. FINRA is therefore proposing to eliminate the current PORTAL reporting rules¹³ and amend the ORF rules to include reporting requirements for all equity securities that are “restricted securities” under Rule 144(a)(3) of the Securities Act and that are traded pursuant to SEC Rule 144A, irrespective of whether they are designated as PORTAL securities. Under the proposed rule change, transactions in all restricted equity securities effected pursuant to SEC Rule 144A would generally be required to be reported to the ORF no later than 8:00 p.m. Eastern Time without interruption.¹⁴ Transactions in restricted equity securities effected pursuant to SEC 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 to the changes relating to restricted equity securities, FINRA is proposing clarifying changes to the definition of “OTC Equity Security” to delete the outdated reference to securities that “qualify for real-time trade reporting” and, instead, to define the term as any

¹³ In addition to the reporting rules, FINRA Rule 6635 specifies which FINRA rules are and are not applicable to transactions and business activities relating to PORTAL securities. FINRA is proposing to retain Rule 6635 as FINRA Rule 6630 to maintain the status quo with respect to the application of FINRA rules to those securities previously designated as PORTAL securities prior to October 26, 2009.

¹⁴ FINRA Rule 6633(a)(2) currently requires that transactions in PORTAL equity securities be reported to the ORF “no later than 6:30 p.m. Eastern Time (or the end of the OTC Reporting Facility reporting session that is in effect at that time).” Since December 4, 2006, the ORF reporting session has remained open until 8:00 p.m. Eastern Time. See Securities Exchange Act Release No. 54773 (November 17, 2006), 71 FR 68665 (November 27, 2006); see also Nasdaq Head Trader Alert 2006-120 (August 23, 2006). The proposed rule change amends the time deadline reference in the rule to reflect the current hours of operation.

equity security that is not an “NMS stock” as defined by the SEC in Regulation NMS.¹⁵ The proposed rule change will also eliminate the defined term “non-exchange-listed security” from Rule 6420.¹⁶ 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.

The proposed rule change also amends 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.”¹⁷ For example, 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.¹⁸ 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.

¹⁵ 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 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).

¹⁶ 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.

¹⁷ See e.g., FINRA Rule 6100, 6200, and 6300 Series.

¹⁸ See FINRA Rules 6282(i)(1)(C), 6380A(e)(1)(C), 6380B(e)(1)(C).

FINRA Rule 6622 sets forth the requirements for members regarding the submission of transaction reports to the ORF for transactions in OTC Equity Securities. While, as discussed above, the FINRA TRF and ADF rules explicitly except transactions executed on or through an exchange, the ORF rules do not include a similar exception for transactions in otherwise eligible securities that are reported on or through an exchange.¹⁹ Thus, FINRA proposes to amend FINRA Rule 6622 to explicitly include an exception for transactions in OTC Equity Securities reported on or through an exchange. In addition, the proposed changes to Rule 6420(k) and Rule 6610 further clarify that transactions in OTC Equity Securities must be reported to the ORF where such transactions are executed otherwise than on or through an exchange.

(b) Amendments to the OATS Rules

FINRA is proposing to conform the definition of “OTC equity security” in Rule 7410 of the OATS rules to the proposed definition in Rule 6420.²⁰ Under the OATS rules, members are required to record and report order information for transactions in equity securities listed on NASDAQ and for “OTC equity securities.”²¹ For purposes of the OATS rules, Rule 7410(l) defines “OTC equity security” as any equity security that: (1) is not listed on a national securities

¹⁹ 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 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).

²⁰ In Amendment No. 1, FINRA states 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.”

²¹ See FINRA Rules 7440 and 7450.

exchange, or (2) is listed on one or more regional stock exchanges and does not qualify for dissemination of transaction reports via the facilities of the Consolidated Tape. The rule currently excludes direct participation program securities from the scope of the OATS requirements, and the proposed rule change will maintain this exclusion.²² The proposed change will not result in any change to the scope of securities required to be reported to OATS. By using substantially similar definitions in both rule series, FINRA will ensure that the appropriate types of securities are addressed throughout FINRA's order reporting, quotation, and trade reporting rules and that key terminology reflects current market structure and trends.

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 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,²³ 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 ensure that FINRA continues to receive important information regarding transactions in restricted securities traded pursuant to SEC Rule 144A.

²² In addition, the proposed rule change codifies prior FINRA guidance that the OATS rules do not apply to orders for restricted equity securities. See Regulatory Notice 06-70 n.2 (December 2006).

²³ 15 U.S.C. 78o-3(b)(6).

FINRA believes that the other proposed changes to the definition of “OTC Equity Security” will ensure that the appropriate types of securities are addressed in the applicable FINRA rules and that key terminology reflects current market structure and trends.

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 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 Exchange 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-2010-003 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-2010-003. 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,²⁴ 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 Web site 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 am and 3:00 pm. 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-

²⁴ The text of the proposed rule change is available on the Commission's Web site at <http://www.sec.gov/>.

FINRA-2010-003 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.²⁵

Florence E. Harmon
Deputy Secretary

²⁵ 17 CFR 200.30-3(a)(12).