

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66829; File No. SR-FINRA-2012-020)

April 18, 2012

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Granting Approval of Proposed Rule Change Relating to Post-Trade Transparency for Agency Pass-Through Mortgage-Backed Securities Traded TBA

I. Introduction

On March 1, 2012, 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”)¹ and Rule 19b-4 thereunder,² a proposed rule change relating to post-trade transparency for Agency Pass-Through Mortgage-Backed Securities (“MBS”) traded “to be announced” or “TBA.” The proposed rule change was published for comment in the Federal Register on March 16, 2012.³ The Commission received no comments on the proposal. This order approves the proposed rule change.

II. Description of the Proposal

FINRA utilizes the Trade Reporting and Compliance Engine (“TRACE”) to collect from its members and publicly disseminate information on secondary over-the-counter transactions in corporate debt securities and Agency Debt Securities and certain primary market transactions.⁴ FINRA also utilizes TRACE to collect information on transactions in Asset-Backed Securities,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 66577 (March 12, 2012), 77 FR 15827 (March 16, 2012) (“Notice”).

⁴ See Securities Exchange Act Release No. 60726 (September 28, 2009), 74 FR 50991 (October 2, 2009) (approving SR-FINRA-2009-010).

but FINRA currently does not disseminate such information publicly.⁵ Agency Pass-Through Mortgage-Backed Securities traded TBA (“MBS TBA”) are a specific type of Asset-Backed Security.⁶ FINRA has proposed to amend its rules to reduce the reporting timeframe for and to provide for public dissemination of MBS TBA transactions, and to make certain other changes.

Good Delivery and Not Good Delivery MBS TBA Transactions

FINRA has proposed to amend the definition of TBA set forth in Rule 6710(u) to identify two subsets of MBS TBA transactions: MBS TBA transactions “for good delivery” (“MBS TBA Good Delivery”) and MBS TBA transactions “not for good delivery” (“MBS TBA Not Good Delivery”). MBS TBA Good Delivery meet certain market standards and conventions, known generally as “good delivery guidelines;” MBS TBA Not Good Delivery do not meet those guidelines.⁷ Most newly issued MBS TBA are MBS TBA Good Delivery, and are composed primarily of standard loans such as 15- and 30-year fixed-rate single-family loans.⁸ Newly issued MBS TBA Not Good Delivery, on the other hand, include primarily non-standard loans, such as interest-only mortgages, project/construction loans, and certain non-conforming mortgages on single family residences.⁹ According to FINRA, MBS TBA Good Delivery are the most liquid and account for the vast majority of MBS TBA transactions.¹⁰

⁵ See Securities Exchange Act Release No. 61566 (February 22, 2010), 75 FR 9262 (March 1, 2010) (approving SR-FINRA-2009-065). The term “Asset Backed Security” is defined in FINRA Rule 6710(m).

⁶ See FINRA Rules 6710(m), (u), and (v).

⁷ See Notice, 77 FR at 15827-28.

⁸ See Notice, 77 FR at 15828.

⁹ See Notice, 77 FR at 15828 n.7.

¹⁰ See Notice, 77 FR at 15828, 15830.

Reduction of Reporting Period

FINRA also has proposed to amend Rule 6730 to reduce the period for reporting MBS TBA transactions to TRACE. The reduction would occur in two stages for both MBS TBA Good Delivery and MBS TBA Not Good Delivery transactions, but the reduced reporting period for each type of MBS TBA transaction would be different.

With respect to MBS TBA Good Delivery transactions, first, for a pilot program of approximately 180 days duration, FINRA has proposed to reduce the reporting period from no later than the close of the TRACE system on the date of execution to no later than 45 minutes from the Time of Execution.¹¹ Second, after approximately 180 days, the pilot program would expire and the reporting period would be reduced from no later than 45 minutes from the Time of Execution to no later than 15 minutes from the Time of Execution.¹²

With respect to MBS TBA Not Good Delivery transactions, first, for a pilot program of approximately 180 days duration, FINRA has proposed to reduce the reporting period from no later than the close of the TRACE system on the date of execution to no later than two hours from the Time of Execution.¹³ Second, after approximately 180 days, the pilot program would

¹¹ See proposed Rule 6730(a)(3)(D)(i)b. Exceptions for transactions that are executed within 45 minutes of the close of the TRACE system and for transactions executed when it is closed are set forth in subparts a., c., and d. of proposed Rule 6730(a)(3)(D)(i). The term “Time of Execution” is defined in Rule 6710(d).

¹² See proposed Rule 6730(a)(3)(D)(ii), which incorporates by reference Rule 6730(a)(1). Rule 6730(a)(1) requires that transactions in TRACE-Eligible Securities be reported within 15 minutes of the Time of Execution, and also provides exceptions for transactions in TRACE-Eligible Securities that are executed shortly before the TRACE system closes and when it is closed.

¹³ See proposed Rule 6730(a)(3)(E)(i)b. Exceptions for transactions that are executed within two hours of the close of the TRACE system and for transactions executed when it is closed are set forth in subparts a., c., and d. of proposed Rule 6730(a)(3)(E)(i).

expire and the reporting period would be reduced from no later than two hours from the Time of Execution to no later than one hour from the Time of Execution.¹⁴

Dissemination of MBS TBA Transaction Information

FINRA Rule 6750(b)(4) currently provides that transactions in Asset-Backed Securities are not subject to dissemination. The proposal would amend Rule 6750(b)(4) to provide for dissemination of information on MBS TBA transactions immediately upon receipt of the transaction report. Specifically, FINRA has proposed to amend Rule 6750(b)(4) to provide that FINRA will not disseminate information on a transaction in an Asset-Backed Security, except an MBS TBA transaction. As a result of this proposed change and the reduced reporting periods that FINRA has proposed for MBS TBA transactions, information on MBS TBA Good Delivery and MBS TBA Not Good Delivery transactions would be disseminated within 45 minutes and two hours, respectively, of the Time of Execution during the pilot period. After the pilot period expires, information on MBS TBA Good Delivery and MBS TBA Not Good Delivery transactions would be disseminated within 15 minutes and one hour, respectively, of the Time of Execution.

Dissemination Caps

FINRA has proposed dissemination caps for MBS TBA Good Delivery and MBS TBA Not Good Delivery transactions, which would prevent the display of the actual size (volume) of a transaction over a certain par value in the disseminated TRACE data.¹⁵ With respect to MBS

¹⁴ See proposed Rule 6730(a)(3)(E)(ii)b. Exceptions for transactions that are executed within one hour of the close of the TRACE system and for transactions executed when it is closed are set forth in subparts a., c., and d. of proposed Rule 6730(a)(3)(E)(ii).

¹⁵ See Notice, 77 FR at 15830. There are currently two dissemination caps already in place. For TRACE-Eligible Securities that are rated Investment Grade, there is a \$5 million dissemination cap, and the size of transactions in excess of \$5 million is displayed as “\$5MM+.” See *id.* For TRACE-Eligible Securities that are rated Non-Investment Grade,

TBA Good Delivery transactions, FINRA would set a dissemination cap of \$25 million. Accordingly, MBS TBA Good Delivery transactions exceeding \$25 million would be displayed in TRACE as “\$25MM+.” With respect to MBS TBA Not Good Delivery transactions, FINRA would set a dissemination cap of \$10 million. Accordingly, MBS TBA Not Good Delivery transactions exceeding \$10 million would be displayed in TRACE as “\$10MM+.”

Data and Fees

FINRA would amend Rule 7730 to make available the disseminated TRACE data for transactions in MBS TBA, and to establish fees for such data. Specifically, FINRA has proposed to amend Rule 7730(c) to establish a real-time market data set for disseminated Asset-Backed Security transaction information (“ABS Data Set”) and to amend Rule 7730(d) to establish a historic data set for such information (“Historic ABS Data Set”).¹⁶ The provisions of Rule 7730 that currently apply to the two existing real-time market and historic data sets (for corporate bonds and Agency Debt Securities), including the fees for receipt of such data, would be amended to include the ABS Data Set and Historic ABS Data Set.

Other Rule Changes

FINRA has proposed to delete provisions regarding an expired pilot program, and to make other minor administrative, technical, or clarifying changes in Rules 6730 and 7730.

there is a \$1 million dissemination cap, and the size of a transaction in excess of \$1 million is displayed as “\$1MM+.” See id. The terms Investment Grade and Non-Investment Grade are defined in Rule 6710(h) and Rule 6710(i), respectively.

¹⁶ The Historic ABS Data Set would include all MBS TBA transactions effected as of or after May 16, 2011, and, among other things, would include uncapped volume information. See Notice, 77 FR at 15831. However, like the other historic TRACE data, data for MBS TBA transactions to be included in the Historic ABS Data Set would be released subject to a delay of approximately 18 months from the date of the transaction. See id.

Regulatory Notice

FINRA has indicated that it would announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval, and that the effective date be no later than 180 days following publication of that Regulatory Notice.

III. Discussion and Commission Findings

After carefully reviewing the proposal, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.¹⁷ In particular, the Commission finds that the proposed rule change is consistent with 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.

In approving the original TRACE rules, the Commission stated that price transparency plays a fundamental role in promoting fairness and efficiency of U.S. capital markets.¹⁹ To further the goal of increasing price transparency in the debt markets in general and the MBS TBA market in particular, the Commission now believes that it is reasonable and consistent with the Act for FINRA to extend post-trade price transparency to transactions in MBS TBA in the manner set forth in the proposal.

¹⁷ 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).

¹⁸ 15 U.S.C. 78o-3(b)(6).

¹⁹ See Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131, 8136 (January 29, 2001).

As discussed above, FINRA uses TRACE to collect information on transactions in Asset-Backed Securities, including MBS TBA transactions, but to date, FINRA has not disseminated such information publicly.²⁰ FINRA's proposal, however, would make MBS TBA transaction information publicly available for the first time, both in near-real time (subject to certain reporting delays, as detailed above) and on a historic basis. By increasing public availability of information about MBS TBA transactions, the proposal may encourage greater participation in the market, which could contribute to deeper liquidity and increased competition. In addition, the proposal appears reasonably designed to reduce the potential for manipulation and promote just and equitable principles of trade by allowing market participants to make more accurate assessments of, and enhancing their ability to negotiate fair and competitive prices in, the MBS TBA market.

Moreover, the Commission believes that the proposed reduction in reporting times for MBS TBA transactions is an important corollary to the expansion of post-trade transparency for such transactions. Timelier reporting should be more conducive to the dissemination of meaningful (and close-to-real time) market data for MBS TBA transactions than FINRA's current reporting regime for MBS TBA transactions.²¹ The Commission believes that reducing the reporting period as set forth in the proposal would result in important trade information reaching the market more quickly, thus contributing to enhanced price transparency for the MBS TBA asset class.

²⁰ See supra note 5.

²¹ The Commission notes further that the 15-minute reporting requirement applicable to MBS TBA Good Delivery after the pilot period is the same reporting requirement applicable to corporate bonds and Agency Debt Securities, i.e., other TRACE-Eligible Securities for which market data are already publicly disseminated. See Rule 6730(a)(1).

Firms covered by these new reporting requirements for MBS TBA transactions could incur certain compliance burdens. However, the Commission believes that any such burdens are justified by the overall benefits of increasing transparency in the MBS market. The Commission notes that FINRA has proposed to shorten the reporting period for MBS TBA transactions in stages. The Commission believes that this approach is reasonably designed to ease the compliance burdens on those affected by the proposal without significantly compromising FINRA's ability to disseminate more timely market data for MBS TBA transactions.

The Commission recognizes that the dissemination caps FINRA has proposed would, to a certain extent, limit the transparency provided by FINRA's proposal.²² However, the Commission notes that dissemination caps are already in place for transactions in other TRACE-Eligible Securities.²³ Moreover, public dissemination of MBS TBA transaction information has heretofore not existed in the MBS TBA market. The dissemination caps allow FINRA to implement post-trade price transparency in that market incrementally. FINRA has represented that it will continue to review the volume of and liquidity in the MBS TBA market and, if warranted in the future, may recommend that the dissemination caps be set at higher levels in order to provide additional transparency.

Lastly, the Commission finds that FINRA's proposed fees for MBS TBA market and historic transaction data are consistent with Section 15A(b)(5) of the Act, which requires, among other things, that FINRA rules provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system which

²² The Commission notes that, as calculated by FINRA, the dissemination caps would have limited the display of actual size for approximately 84% of total volume traded in MBS TBA Good Delivery and 85% of total volume traded in MBS TBA Not Good Delivery during the period May 16, 2011 through January 4, 2012. See Notice, 77 FR at 15830 and n.26.

²³ See supra note 15.

the association operates or controls. These fees are similar to those that currently apply to corporate debt securities and Agency Debt Securities.²⁴

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁵ that the proposed rule change (SR-FINRA-2012-020) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁶

Kevin M. O'Neill
Deputy Secretary

²⁴ See FINRA Rule 7730.

²⁵ 15 U.S.C. 78s(b)(2).

²⁶ 17 CFR 200.30-3(a)(12).