

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68084; File No. SR-FINRA-2012-042)

October 23, 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 in Specified Pool Transactions and SBA-Backed Asset-Backed Securities Transactions

I. Introduction

On August 29, 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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change relating to post-trade transparency for Agency Pass-Through Mortgage-Backed Securities (“MBS”) traded in Specified Pool Transactions (“SPT” and, together with MBS, “MBS SPT”) and Asset-Backed Securities backed by loans guaranteed as to principal and interest by the Small Business Administration (“SBA-Backed ABS”) and traded either SPT (“SBA-Backed ABS SPT”) or To Be Announced (“TBA” and, together with SBA-Backed ABS, “SBA-Backed ABS TBA”).<sup>3</sup> The proposed rule change was published for comment in the Federal Register on September 13, 2012.<sup>4</sup> The Commission received no comments on the proposal. This order approves the proposed rule change.

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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> The terms “Asset-Backed Security,” “TBA,” “Agency Pass-Through Mortgage-Backed Security” and “Specified Pool Transaction” are defined in FINRA Rules 6710(m), (u), (v) and (x), respectively.

<sup>4</sup> See Securities Exchange Act Release No. 67798 (September 7, 2012), 77 FR 56686 (“Notice”).

## 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. FINRA also utilizes TRACE to collect information on transactions in Asset-Backed Securities but, until recently, FINRA did not disseminate such information publicly.<sup>5</sup> Earlier this year, however, FINRA amended its rules to reduce the reporting timeframe for and to provide for public dissemination of information regarding transactions in Agency Pass-Through Mortgage-Backed Securities traded TBA (“MBS TBA”), a type of Asset-Backed Security.<sup>6</sup> FINRA has now proposed to reduce the reporting timeframe for and to provide for public dissemination of information regarding transactions in additional types of Asset-Backed Securities, namely, MBS SPT and SBA-Backed ABS transactions, and to make certain other changes.

### Reduction of Reporting Period

FINRA has proposed to amend its Rule 6730 to reduce the period for reporting MBS SPT and SBA-Backed ABS transactions to TRACE. The reduction would occur in two stages. First, for a pilot program of approximately 180 days, FINRA will 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.<sup>7</sup> Second, after approximately 180 days, the pilot program will

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<sup>5</sup> See Securities Exchange Act Release No. 61566 (February 22, 2010), 75 FR 9262 (March 1, 2010) (approving SR-FINRA-2009-065).

<sup>6</sup> See Securities Exchange Act Release No. 66829 (April 18, 2012), 77 FR 24748 (April 25, 2012) (approving SR-FINRA-2012-020) (“FINRA-2012-020 Approval”).

<sup>7</sup> However, there are exceptions for transactions that are executed within two hours of the close of the TRACE system and for transactions executed when TRACE is closed.

expire and the reporting period will be reduced from no later than two hours from the Time of Execution to no later than one hour from the Time of Execution.<sup>8</sup>

#### Dissemination of MBS SPT and SBA Backed ABS Transaction Information

Recently, FINRA Rule 6750(b)(4) was amended to provide for dissemination of information on MBS TBA transactions immediately upon receipt of the transaction report.<sup>9</sup> FINRA's current proposal would amend Rule 6750(b)(4) so that it also provides for dissemination of information on MBS SPT and SBA Backed ABS 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 in the case of MBS transactions – which include MBS TBA as well as MBS SPT – or SBA-Backed ABS transactions. As a result of this proposed change and the reduced reporting periods that FINRA has proposed for MBS SPT and SBA-Backed ABS transactions, information on such transactions will be disseminated within two hours of the Time of Execution during the pilot period and within one hour of the Time of Execution after the pilot period expires.

#### Dissemination Protocols

The dissemination of information on MBS SPT and SBA Backed ABS transactions will be subject to certain dissemination protocols, in addition to the dissemination cap discussed below. SBA-Backed ABS TBA transactions will be subject to the same protocols that apply to MBS TBA transactions “not for good delivery” and standard data elements will be displayed.<sup>10</sup>

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<sup>8</sup> See supra note 7.

<sup>9</sup> See FINRA 2012-020 Approval.

<sup>10</sup> See FINRA 2012-020 Approval; see also Notice, 77 FR at 56688 and n.20.

With respect to MBS SPT and SBA Backed ABS SPT transactions, however, FINRA has proposed not to disseminate the specific CUSIP of the security traded. Instead, FINRA has proposed to disseminate certain publicly available data elements that correspond to the reported CUSIP (without actually disseminating the CUSIP).<sup>11</sup> Specifically, for each MBS SPT transaction reported to TRACE, FINRA would disseminate in lieu of a CUSIP, the product type, amortization type, issuing agency, coupon, original maturity, weighted average coupon (“WAC”), weighted average maturity (“WAM”), weighted average loan age (“WALA”), average loan size (“ALS”), and original loan-to-value (“original LTV”). For each SBA-Backed ABS SPT transaction reported to TRACE, FINRA would disseminate in lieu of a CUSIP, the amortization type, coupon, original maturity, WAC, WAM, and WALA, except that such values would be based on SBA-backed pooled loans. Each numerical data element (which would not include issuing agency, product type or amortization type) will be expressed in ranges (*i.e.*, the information will be truncated and rounded up or down).

#### Dissemination Cap

FINRA has proposed a dissemination cap of \$10 million for MBS SPT and SBA Backed ABS transactions, which would prevent the display in disseminated TRACE data of the actual size (volume) of MBS SPT and SBA Backed ABS transactions with a par value over \$10 million; rather, such transactions will be displayed as “10MM+.”<sup>12</sup>

#### Other Rule Changes

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<sup>11</sup> See Notice, 77 FR at 56688-90.

<sup>12</sup> See Notice, 77 FR at 56690. Certain dissemination caps are already in place. There are \$5 million and \$1 million caps for TRACE-Eligible Securities that are rated Investment Grade and Non-Investment Grade, respectively, which pre-date the FINRA-2012-020 Approval. See id. There are also \$25 million and \$10 million dissemination caps for transactions in MBS TBA, with the \$25 million cap applying to one subset of MBS TBA transactions and the \$10 million cap applying to another subset. See FINRA-2012-020 Approval.

FINRA has proposed to amend FINRA Rule 6710 to add “SBA-Backed ABS” as a defined term<sup>13</sup> and to make conforming amendments to the definitions of TBA, MBS, and SPT in Rules 6710(u), (v), and (x), respectively, in order to incorporate SBA-Backed ABS.

#### Regulatory Notice

FINRA has stated 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 careful review, 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.<sup>14</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,<sup>15</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.

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.<sup>16</sup> To further the goal of increasing price transparency in the debt markets in general and the MBS SPT and SBA-Backed ABS markets in particular, the Commission now believes that it is reasonable

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<sup>13</sup> See proposed Rule 6710(bb).

<sup>14</sup> 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).

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

<sup>16</sup> See Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131, 8136 (January 29, 2001).

and consistent with the Act for FINRA to extend post-trade price transparency to transactions in MBS SPT and SBA-Backed ABS in the manner set forth in the proposal.

As discussed above, FINRA recently amended its rules to provide for public dissemination (and timelier reporting to TRACE) of information on transactions in MBS TBA.<sup>17</sup> The current proposal will continue this initiative by making information on MBS SPT and SBA-Backed ABS transactions publicly available for the first time. In doing so, the proposal could encourage greater participation in the market, and thereby 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 SPT and SBA-Backed ABS markets.

Further, the Commission believes that the proposed dissemination protocols for MBS SPT and SBA-Backed ABS SPT transactions, pursuant to which specified data elements would be disseminated in lieu of actual CUSIPs, strike an appropriate balance between providing meaningful post-trade transparency and, at the same time, reducing the potential for “reverse engineering” of transaction data that could permit identification of a market participant and/or its trading strategy. According to FINRA, part of the valuation analysis of any Asset-Backed Security includes a projection of its cash flow which, in turn, relies on assumptions about prepayment rates.<sup>18</sup> FINRA believes that the specified data elements that will be disseminated for MBS SPT and SBA-Backed ABS SPT transactions provide information that will allow market participants to perform such an analysis.<sup>19</sup> Moreover, FINRA has represented that, in the

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<sup>17</sup> See FINRA-2012-020 Approval.

<sup>18</sup> See Notice, 77 FR at 56689.

<sup>19</sup> See id.

future, it could determine to propose dissemination of additional data elements that it believes would improve transparency for such transactions.<sup>20</sup>

Additionally, the proposed reduction in reporting times for MBS SPT and SBA-Backed ABS 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) MBS SPT and SBA-Backed ABS transaction information. 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 SPT and SBA-Backed ABS asset classes.

Firms covered by these new reporting requirements for MBS SPT and SBA-Backed ABS 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 SPT and SBA-Backed ABS markets. The Commission notes that FINRA has proposed to shorten the reporting period for MBS SPT and SBA-Backed ABS 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 transaction information for MBS SPT and SBA-Backed ABS transactions.

The Commission recognizes that the \$10 million dissemination cap FINRA has proposed would, to a certain extent, limit the transparency provided by FINRA's proposal.<sup>21</sup> However, the Commission notes that dissemination caps are already in place for transactions in other TRACE-

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<sup>20</sup> See id.

<sup>21</sup> The Commission notes that, as calculated by FINRA, the \$10 million dissemination cap would have limited the display of actual size for approximately 80% of total volume traded in MBS SPT and SBA-Backed ABS during the period May 16, 2011 through January 4, 2012. See Notice, 77 FR at 56690 and n.28.

Eligible Securities.<sup>22</sup> Moreover, public dissemination of information on MBS SPT and SBA-Backed ABS transactions has heretofore not existed in the MBS SPT and SBA-Backed ABS markets. The dissemination cap will allow FINRA to implement post-trade price transparency in those markets incrementally. Furthermore, FINRA has represented that it will continue to review the volume of and liquidity in those markets and, if warranted in the future, may propose that the dissemination cap be set at a higher level in order to provide additional transparency.<sup>23</sup>

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>24</sup> that the proposed rule change (SR-FINRA-2012-042) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>25</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>22</sup> See supra note 13.

<sup>23</sup> See Notice, 77 FR at 56690.

<sup>24</sup> 15 U.S.C. 78s(b)(2).

<sup>25</sup> 17 CFR 200.30-3(a)(12).