

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69037; File No. SR-FINRA-2012-052)

March 5, 2013

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Granting Approval of Proposed Rule Change to Require Members to Report to TRACE the “Factor” in Limited Instances Involving Asset-Backed Security Transactions

I. Introduction

On November 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”)¹ and Rule 19b-4 thereunder,² a proposed rule change to require FINRA members to report to the Trade Reporting and Compliance Engine (“TRACE”) the Factor used to determine the size (volume) of each transaction in an Asset-Backed Security (“ABS”) (except ABS traded To Be Announced (“TBA”)), in the limited instances when members effect such transactions as agent and charge a commission.³ The proposed rule change was published for comment in the Federal Register on December 18, 2012.⁴ The Commission received one comment on the proposal and a response to the comment from FINRA.⁵ On January 30, 2013, the Commission extended to March 18, 2013 the time period in which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether the proposed rule change should be

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The terms “Asset-Backed Security,” “To Be Announced,” and “Factor” are defined in FINRA Rules 6710(m), (u), and (w), respectively.

⁴ See Securities Exchange Act Release No. 68414 (December 12, 2012), 77 FR 74896 (“Notice”).

⁵ See comment from Mark Sokolow, dated December 18, 2012 (“Sokolow Comment”); see also response letter from Kathryn Moore, Assistant General Counsel, FINRA, to Elizabeth M. Murphy, Secretary, Commission, dated January 11, 2013 (“FINRA Letter”).

disapproved.⁶ This order approves the proposed rule change.

II. Description of the Proposal

FINRA utilizes TRACE to collect from its members and publicly disseminate information on secondary over-the-counter transactions in corporate debt securities and Agency Debt Securities⁷ and certain primary market transactions. FINRA also utilizes TRACE to collect information on ABS transactions but, until recently, FINRA's rules did not provide for the dissemination of such information publicly.⁸ Last year, however, FINRA amended its rules to provide for public dissemination of information regarding, among other things, certain ABS traded in Specified Pool Transactions.⁹ FINRA has proposed the instant rule change to prepare for such dissemination, which has not yet become effective, as well as to prepare for any future dissemination of additional ABS market segments.¹⁰

Specifically, FINRA has proposed to amend FINRA Rule 6730(d)(2) to require a member to report to TRACE the Factor in the limited instances when the member effects a transaction in an ABS (except a TBA transaction) as agent and charges a commission.¹¹ Under FINRA's current transaction reporting rules, for a transaction in an ABS that is backed by mortgages or other assets that amortize over the life of the security, instead of reporting the size

⁶ See Securities Exchange Act Release No. 68768 (January 30, 2013), 78 FR 8216 (February 5, 2013).

⁷ The term "Agency Debt Security" is defined in FINRA Rule 6710(l).

⁸ See Securities Exchange Act Release No. 61566 (February 22, 2010), 75 FR 9262 (March 1, 2010) (approving SR-FINRA-2009-065).

⁹ See Securities Exchange Act Release No. 68084 (October 23, 2012), 77 FR 65436 (October 26, 2012) (approving SR-FINRA-2012-042). The term "Specified Pool Transaction" is defined in FINRA Rule 6710(x).

¹⁰ See Notice, 77 FR at 74896.

¹¹ See proposed Rule 6730(d)(2)(B)(iv); see also Notice, 77 FR at 74896. FINRA stated that only a small number of ABS transactions are executed on an agency basis with a commission charged; ABS are traded mostly on a principal basis. See id.

of the transaction by reporting the total par or principal value, a member must report two items from which the size is calculable: (1) the original face value of the ABS, which is the size at issuance; and (2) the Factor, but only if the Factor used to execute the transaction is not the most current Factor that is publicly available at the Time of Execution¹² (a “non-conforming Factor”).¹³ As a result of the proposed rule change, when an ABS transaction (except for a TBA transaction) is executed in an agency capacity with a commission charged, the FINRA member would be required to report the Factor regardless of whether it is the most current Factor publicly available at the Time of Execution or is a non-conforming Factor.¹⁴ In addition, FINRA has proposed supplementary material to make clear that the requirement to report the Factor will apply to every ABS transaction (except for a TBA transaction) executed in an agency capacity with a commission charged, including the small number of transactions in non-amortizing ABS.¹⁵

FINRA has also proposed technical amendments to reorganize the current size reporting requirements in FINRA Rule 6730(d)(2) and to make them consistent with proposed Rule 6730(d)(2)(B)(iv).¹⁶

¹² The term “Time of Execution” is defined in FINRA Rule 6710(d).

¹³ See FINRA Rules 6730(c)(2) and (d)(2); see also Notice, 77 FR at 74896. When a member uses the most current Factor that is publicly available at the Time of Execution of the transaction, the member currently is not required to report the Factor. Instead, the TRACE system incorporates the most current Factor publicly available at the Time of Execution. FINRA receives such information from commercial data vendors. See Notice, 77 FR at 74896 n.7.

¹⁴ See proposed Rule 6730(d)(2)(B)(iv); see also Notice, 77 FR at 74897.

¹⁵ See proposed supplementary material .01 to Rule 6730(d)(2); see also Notice, 77 FR at 74897. For transactions in non-amortizing ABS, a member would be required to report 1.0 as the Factor. See id. at 74897 n.11.

¹⁶ See proposed Rules 6730(d)(2)(A)-(2)(B)(iv).

FINRA stated 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, and that the effective date will be no later than 270 days following publication of the Regulatory Notice.¹⁷

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.¹⁸ In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,¹⁹ 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.²⁰ FINRA believes that the proposed rule change would promote price transparency provided by TRACE for ABS transactions executed in an agency capacity with a commission charged.²¹ When an ABS transaction is executed in an agency capacity with a commission charged, the TRACE system must take the Factor, as well as other information, into account when calculating the

¹⁷ See Notice, 77 FR at 74897.

¹⁸ 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).

¹⁹ 15 U.S.C. 78o-3(b)(6).

²⁰ See Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131, 8136 (January 29, 2001).

²¹ See Notice, 77 FR at 74897.

disseminated price of the transaction.²² Currently, all components of the formula that would be used to calculate a disseminated price in an agency ABS transaction, except the Factor, are reported by a member effecting the transaction.²³ FINRA represented that requiring that the Factor also be reported would ensure the accuracy of the disseminated price for an agency ABS transaction because the TRACE system would rely exclusively upon information reported by the members that are parties to such a transaction in calculating the transaction's disseminated price.²⁴ The Commission believes that the proposal is reasonably designed to promote the accuracy of the disseminated price data for agency ABS transactions and to further the goal of increasing price transparency in the ABS market.

The commenter suggested that the proposed rule change would add an administrative burden to the industry.²⁵ FINRA responded that the proposed rule change is necessary and appropriate, and noted that it would be narrowly tailored to apply to the very limited number of ABS transactions where a member trades in an agency capacity and charges a commission.²⁶ FINRA also noted that the accuracy of the price transparency provided by TRACE assists all market participants in determining the quality of their executions and firms in complying with their regulatory obligations.²⁷ The Commission believes that the commenter has not raised any issue that would preclude approval of the proposal.

²² See id. at 74896-97.

²³ See id. at 74897.

²⁴ See id.

²⁵ See Sokolow Comment.

²⁶ See FINRA Letter at 2.

²⁷ See id.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁸ that the proposed rule change (SR-FINRA-2012-052) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁹

Kevin M. O'Neill
Deputy Secretary

²⁸ 15 U.S.C. 78s(b)(2).

²⁹ 17 CFR 200.30-3(a)(12).