

Regulatory Notice

19-25

Trade Reporting and Compliance Engine (TRACE)

FINRA Requests Comment on a Proposal to Require Reporting of Transactions in U.S. Dollar-Denominated Foreign Sovereign Debt Securities to TRACE

Comment Period Expires: September 24, 2019

Summary

FINRA requests comment on a proposal to expand TRACE reporting requirements to collect information on trades in foreign sovereign debt securities that are U.S. dollar-denominated. Issuance activity in these debt securities has accelerated in recent years and FINRA believes the proposal would provide important regulatory information on an increasingly active segment of the market. Under the proposal, trades in U.S. dollar-denominated foreign sovereign debt securities would be subject to same-day reporting and would not be disseminated publicly.

The proposed rule text is set forth in Attachment A.

Questions regarding this *Notice* should be directed to:

- ▶ Alié Diagne, Director, Transparency Services, at (212) 858-4092 or alie.diagne@finra.org;
- ▶ Joseph Schwetz, Senior Director, Market Regulation, at (240) 386-6170 or joseph.schwetz@finra.org;
- ▶ Alex Ellenberg, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8152 or alexander.ellenberg@finra.org; or
- ▶ Cara Bain, Assistant General Counsel, OGC, at (202) 728-8852 or cara.bain@finra.org.

July 26, 2019

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Fixed Income
- ▶ Legal
- ▶ Operations
- ▶ Systems
- ▶ Trading
- ▶ Training

Key Topics

- ▶ Foreign Sovereign Debt
- ▶ Fixed Income
- ▶ TRACE
- ▶ TRACE-Eligible Security
- ▶ Trade Reporting

Referenced Rules and Regulatory Notices

- ▶ FINRA Rule 6710
- ▶ FINRA Rule 6730
- ▶ FINRA Rule 6750
- ▶ FINRA Rule 7730
- ▶ *Notice to Members 04-90*

19-25

July 26, 2019

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by September 24, 2019.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to pubcom@finra.org; or
- ▶ Mailing comments in hard copy to:

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA website. Generally, FINRA will post comments as they are received.¹

Before becoming effective, the proposed rule change must be filed with the Securities and Exchange Commission (SEC) pursuant to Section 19(b) of the Securities Exchange Act (SEA).²

Background and Discussion

Currently almost all U.S. dollar-denominated debt securities traded in the U.S., excluding money market instruments, are considered “TRACE-Eligible Securities” and therefore subject to TRACE reporting requirements.³ This includes the U.S. dollar-denominated debt of foreign private issuers.⁴ However, trades in the U.S. dollar-denominated debt of foreign sovereign issuers are not subject currently to TRACE reporting.

U.S. dollar-denominated foreign sovereign debt issuance has increased substantially since 2013. To further enhance FINRA’s regulatory audit trail, FINRA is proposing to require TRACE reporting of U.S. dollar-denominated foreign sovereign debt. FINRA believes this would provide important regulatory information on an increasingly active segment of the market. Based on discussions with member firms and feedback from advisory committees, FINRA understands that U.S. dollar-denominated foreign sovereign debt securities generally trade on desks that already have TRACE reporting workflows in place and therefore, FINRA preliminarily believes the proposal would advance this regulatory goal through incremental measures and would not impose significant burdens and costs on firms. FINRA is requesting additional feedback and comment on the specific economic impacts, as well as the overall goals and impacts of the proposal as discussed in more detail below.

Scope of Proposed Reporting Requirements

Under the proposal, FINRA would require members to report transactions in U.S. dollar-denominated foreign sovereign debt securities, a term that would be defined to include debt securities that are issued or guaranteed by the government of a foreign country, any political subdivision of a foreign country, or a supranational entity.⁵ Supranational entities are multi-national organizations such as the International Bank for Reconstruction & Development (“World Bank”), the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the International Finance Corporation, and the European Investment Bank.

The proposal would not change FINRA’s approach to the regulatory reporting framework or jurisdictional reach over trading activity with some foreign component. The proposed reporting requirements for U.S. dollar-denominated foreign sovereign debt securities would follow the current TRACE approach to foreign trades, which generally considers whether FINRA member firms engage in transactions that involve a beneficial change in ownership.⁶

Under the proposal, transaction information for U.S. dollar-denominated foreign sovereign debt securities would be reported for regulatory purposes only and would not be publicly disseminated.⁷ Transactions in foreign sovereign debt securities would be subject to same-day reporting during current TRACE hours. Specifically, transactions between midnight and 5:00 p.m. Eastern Time (ET) on a business day must be reported on that business day, and transactions between 5:00 p.m. ET and midnight—as well as transactions on any day the TRACE system is not open—must be reported no later than 6:29:59 p.m. ET of the next business day (and designated “as/of” the date of execution).

For trades in U.S. dollar-denominated foreign sovereign debt securities subject to the proposal, FINRA would require firms to report specific transaction information similar to what is reported for other TRACE-Eligible Securities. Specifically, TRACE trade reports in foreign sovereign debt securities would be required to include:

- ▶ the CUSIP number or FINRA symbol for the security;
- ▶ the reporting party’s capacity;
- ▶ an identifier for the contra-party (either MPID, “A” for non-member affiliate, or “C” for customer);
- ▶ the side the reporting party was on (buy or sell);
- ▶ the quantity of the transaction (*i.e.*, face value amount of the transaction);
- ▶ the price of the transaction expressed as a percentage of face/par value;
- ▶ the time of execution;
- ▶ the date of execution (for “as/of” trades);
- ▶ the settlement date;
- ▶ any commission charged if the member is acting as agent; and
- ▶ any applicable trade modifiers.

If U.S. dollar-denominated foreign sovereign debt securities become subject to TRACE reporting requirements, they would also become subject to applicable transaction reporting fees. FINRA is not proposing any change to the current rate structure set out in Rule 7730, which means that U.S. dollar-denominated foreign sovereign debt securities would be treated the same as corporate debt securities for purposes of trade reporting fees under the rule. Similarly, once TRACE-Eligible, U.S. dollar-denominated foreign sovereign debt securities would become subject to the Trading Activity Fee at the rate applicable to bonds set out in Section 1 of Schedule A to FINRA's By-Laws.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to analyze the potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects relative to the current baseline, and the alternatives FINRA considered in assessing how to best meet its regulatory objectives.

Regulatory Objective

FINRA is proposing that members be required to report transactions in U.S. dollar-denominated foreign sovereign debt securities to TRACE subject to same-day reporting. These foreign sovereign debt security transactions would not be disseminated publicly.

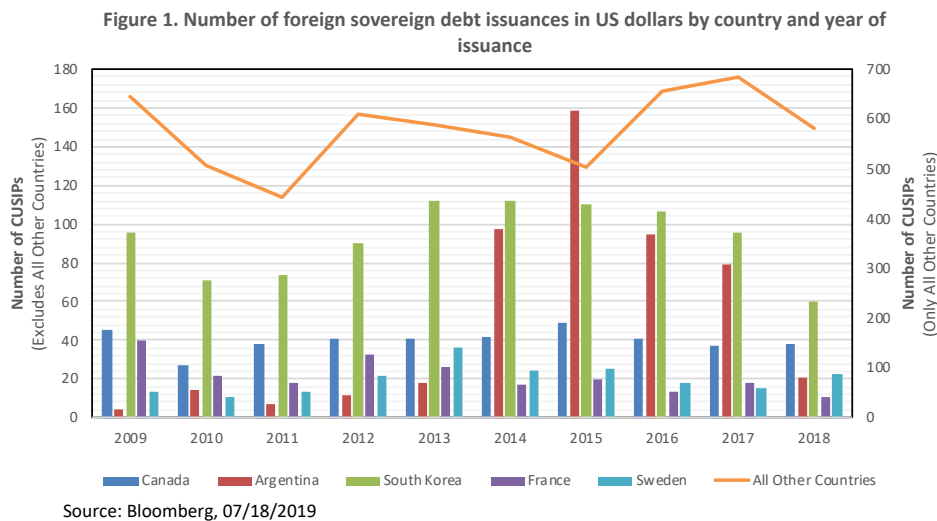
Economic Baseline

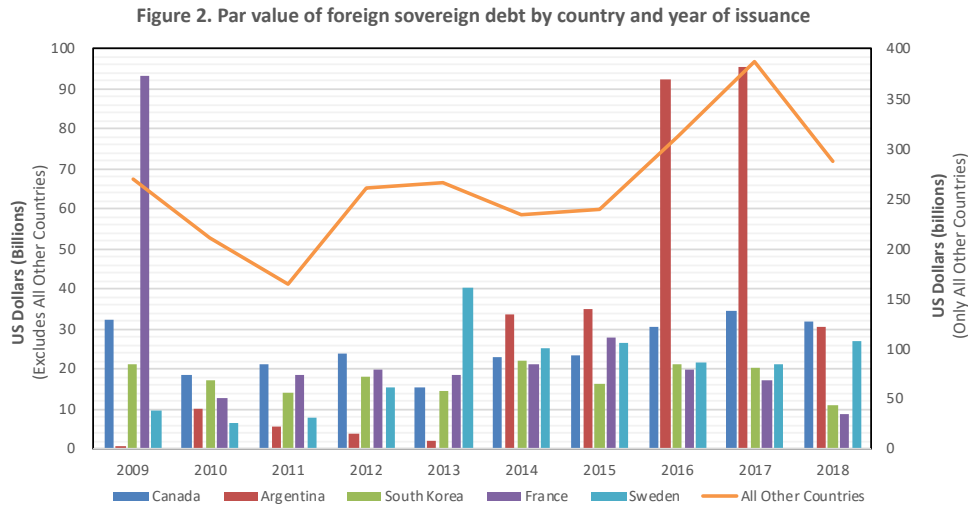
FINRA members are not currently required to report transactions in U.S. dollar-denominated foreign sovereign debt securities to TRACE. As a consequence, there is not current TRACE data to estimate the amount of trading volume that will be subject to reporting. This analysis is therefore informed by data on the issuance and amount outstanding of these securities obtained from other sources.

As of December 31, 2018, the total amount outstanding of marketable U.S. dollar-denominated foreign sovereign government debt was approximately \$2.3 trillion across 4,827 CUSIPs issued by 116 foreign sovereign governments. This compares to approximately \$16.0 trillion, \$2.3 trillion and \$8.4 trillion, respectively, in marketable U.S. Treasury debt, U.S. agency debt and U.S. corporate debt.⁸

Governments issued approximately \$16.6 trillion of marketable U.S. dollar-denominated debt in calendar year 2018. Foreign sovereign governments issued \$396 billion of it, representing approximately 2.4% of the total amount, and the U.S. Government (U.S. Treasury and agencies) issued the remaining amount, \$16.2 trillion.⁹ By comparison, foreign and U.S. firms issued a total of \$3.8 trillion of corporate debt denominated in U.S. dollars in calendar year 2018.

The number of foreign sovereign U.S. dollar-denominated debt issuances has increased from 842 to 929 unique CUSIPs per year from 2009 through 2017; foreign sovereign governments issued 734 unique CUSIPs in U.S. dollar-denominated debt in 2018. As shown in Figure 1, the top five non-U.S. government issuers of marketable U.S. dollar-denominated debt in the years from January 1, 2014 through December 31, 2018, as measured by par value, are Canada, Argentina, South Korea, France and Sweden. In particular, Argentina has increased its issuance of sovereign U.S. dollar-denominated debt by a multiple of 5.25 between the years 2009 and 2018, as measured by the number of unique CUSIPs. Figure 2 shows how the amount of U.S. dollar-denominated sovereign debt issued has changed. For example, Argentina and Sweden increased their debt issuance denominated in U.S. dollars by a multiple of 100.3 and 2.8, respectively, between the years 2009 and 2018.

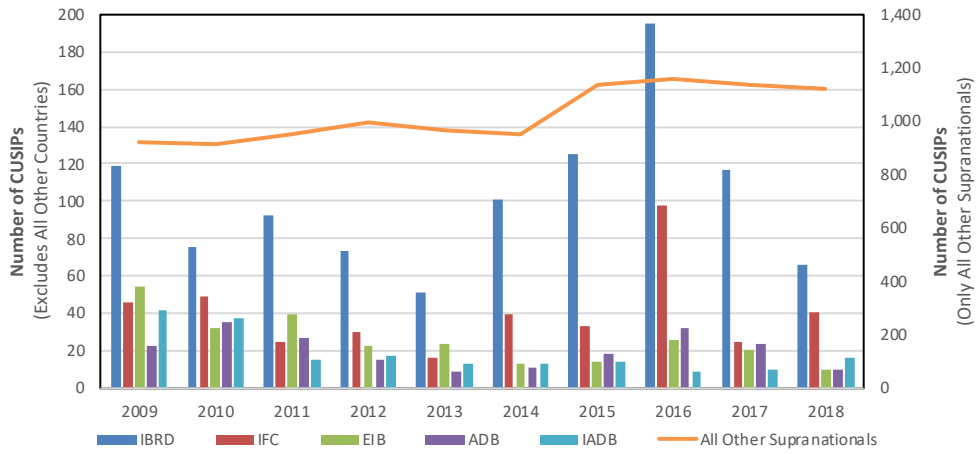




In calendar year 2018, the total amount outstanding of marketable U.S. dollar-denominated supranational debt is approximately \$552 billion across close to 2,667 CUSIPs issued by 31 supranational organizations. The top-five largest supranational issuers of marketable U.S. dollar-denominated debt from January 1, 2014 to December 31, 2018, as measured by par value is about 64.4% of the total amount outstanding. These five entities are International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC), European Investment Bank (EIB), Asian Development Bank (ADB) and Inter-American Development Bank (IADB).

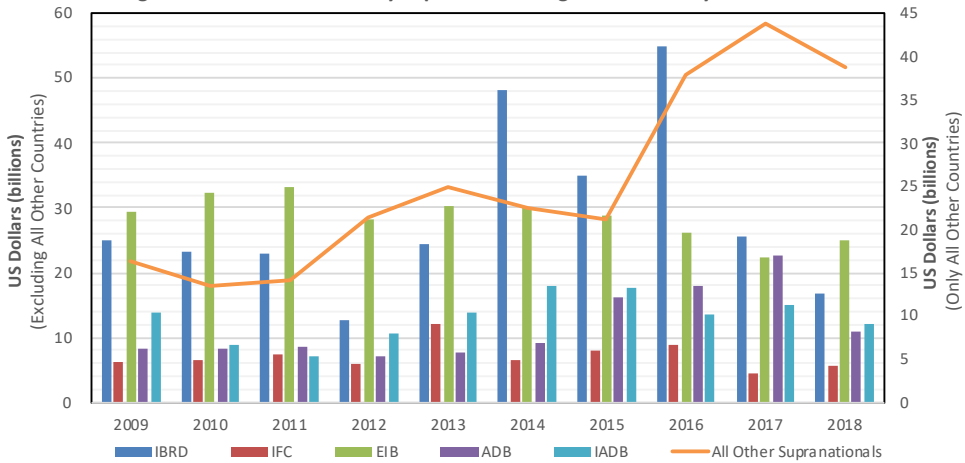
Figure 3 shows that the number of supranational U.S. dollar-denominated debt issuances has increased slightly from 1,203 to 1,264 unique CUSIPs from 2009 through 2018. In calendar year 2018, the International Bank for Reconstruction and Development made the largest number of issuances, 66 CUSIPs, out of a total of 21 supranational organizations. Figure 4 also shows that the U.S. dollar-denominated debt issued by supranational organizations has increased from \$99.1 billion in calendar year 2009 and is \$109.1 billion as of calendar year 2018, of which \$70.3 billion is issued from the top five largest supranational issuers of U.S. dollar-denominated debt in the time from January 1, 2014 through December 31, 2018, as measured by par value.

Figure 3. Number of debt issuances in US dollars by supranational organization and year of issuance



Source: Bloomberg, 07/18/2018

Figure 4. Par value of debt by supranational organization and year of issuance



Source: Bloomberg, 07/18/2018

Based on discussions with active broker-dealers in multiple foreign sovereign debt markets, FINRA understands that U.S. dollar-denominated foreign sovereign debt securities are not generally viewed as fungible investment substitutes for foreign currency (*i.e.*, non-U.S. dollar) foreign sovereign debt securities and, as such, that arbitrage trading between these securities is *de minimis*.

Economic Impact

The primary benefit from members reporting transactions in U.S. dollar-denominated foreign sovereign debt securities to TRACE is that FINRA would be better able to supervise the market. In particular, the addition of the transaction price, par value, and other trade information in TRACE would create a better informed surveillance program to help detect fraud, manipulation, unfair pricing and other potential misconduct. Academic studies have found a positive empirical relationship between the strength of market regulation and market quality.¹⁰

As the transactions will initially not be publicly disseminated,¹¹ no additional costs or benefits from increased transparency will be imposed on market participants. FINRA and its members may face some additional development costs, but they are expected to be relatively modest because no new transaction information or modifiers are required beyond that mandated for corporate bonds. Members will pay a Transaction Reporting Fee and Trading Activity Fee for each U.S. dollar-denominated foreign sovereign or supranational debt security reported to TRACE, and FINRA is expected to bear the incremental cost of receiving and storing each of these additional transactions and conducting associated regulation. Because there is not current TRACE data to estimate the amount of trading volume that will be subject to reporting under the proposal, FINRA is not able to estimate the anticipated aggregate amount that would be collected through these fees.

As there is currently no definitive source for transactions in U.S. dollar-denominated foreign sovereign debt securities, FINRA is not able to ascertain whether transactions between non-FINRA members represent a material (or potentially material) amount of execution activity in this market. Based on preliminary discussions with several market participants, FINRA understands that non-FINRA members hold U.S. dollar denominated foreign sovereign debt securities but generally execute through FINRA members. To the extent the number of transactions between non-FINRA members is significant, the proposal may be anticipated to impose some competitive effects. In particular, some market participants may seek to ensure that their activities are not reported to FINRA so as to avoid surveillance. This could result in trading activities shifting from FINRA members to non-members. However, FINRA believes this impact is mitigated to the extent that U.S. dollar-denominated foreign sovereign debt securities are not exempted securities under the federal securities laws and are required to be transacted in the U.S. through a registered broker-dealer.

In addition, based on FINRA's understanding, noted above, that market participants do not treat debt issued by a foreign sovereign in dollars as fungible with debt issued by the same foreign sovereign in local or other currency, FINRA does not believe firms would be likely to avoid the proposed reporting requirements by shifting trading from U.S. dollar-denominated foreign sovereign debt to foreign sovereign debt denominated in other currency. FINRA also believes the ability to shift trading activity in U.S. dollar-denominated foreign sovereign debt securities to foreign jurisdictions to avoid the proposed reporting requirements is mitigated to the extent such trades are reportable in those jurisdictions, for example, in Europe. This *Notice* includes questions below to solicit additional feedback on these potential competitive issues.

FINRA estimates that the benefit from improved surveillance of the U.S. dollar-denominated foreign sovereign and supranational debt securities to market participants outweighs the costs to members for having to report and to FINRA for receiving these additional transaction reports.

Alternatives Considered

No alternatives are under consideration.

Request for Comment

FINRA requests comment on all aspects of the proposal. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible. FINRA specifically requests comment concerning the following questions:

- ▶ Do you agree with the scope of the proposal?
 - ▶ Is there another definition for the term "foreign sovereign debt security" that FINRA should consider?
 - ▶ Should FINRA consider a different reporting timeframe for trades in U.S. dollar-denominated foreign sovereign debt securities?
 - ▶ Would you propose any changes to the specific transaction information that the proposal would require for trades in U.S. dollar-denominated foreign sovereign debt securities?
 - ▶ Should non-U.S. dollar-denominated foreign sovereign debt securities be included and, if so, how would they be reported?
- ▶ What other economic impacts, including costs and benefits, might be associated with the proposal? Who might be affected and how?

- ▶ Is there more specific information on the direct costs of the proposal that FINRA should consider?
 - ▶ For example, are there U.S. dollar-denominated foreign sovereign debt securities that trade on desks that do not already have TRACE-reporting workflows in place?
 - ▶ If so, what are the costs of adding TRACE-reporting workflows to such desks?
- ▶ Would the proposal, if adopted, encourage investors to change their trading behavior to avoid TRACE reporting? If so, how do you envision investors would do so and what impacts do you think such changes would have?
- ▶ FINRA understands that today, firms may employ a manual process to determine whether a U.S. dollar denominated foreign debt security is Schedule B eligible and therefore not reportable. Would the proposal reduce the burdens and potential costs associated with determining whether a U.S. dollar-denominated debt security was issued by a foreign private issuer or a foreign sovereign issuer, since both would be reportable?
- ▶ Would the proposal impose any other competitive impacts that FINRA has not considered?

Endnotes

1. Persons submitting comments are cautioned that FINRA does not redact or edit personal identifying information, such as names or email addresses, from comment submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
2. *See* Section 19 of the SEA and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.
3. *See* Rule 6710(a).
4. *See* Rule 6710(a)(1). FINRA guidance states that “foreign private issuer” means a foreign issuer that is not eligible to use the SEC’s Schedule B for registering a debt offering in the United States. Schedule B is used to register debt for issuance in the United States by foreign governments or political subdivisions of foreign governments, and in some cases supranational organizations, issuers of government-guaranteed securities, and certain other issuers closely aligned and identified with a sovereign. *See Notice to Members 04-90* (December 2004).
5. The proposal would do this by amending Rule 6710 to add a new definition for “Foreign Sovereign Debt Security” and to add the term to the definition of “TRACE-Eligible Security.” The new definition for “Foreign Sovereign Debt Security” would closely track a definition for the same term adopted by the SEC in connection with Regulation ATS.
6. *See, e.g.*, FINRA TRACE FAQ 3.16 (providing guidance on requirements for reporting trades that involve off-shore subsidiaries).
7. If the proposed rule change is adopted, FINRA would take a similar measured approach to potential dissemination that it has taken historically with other TRACE-eligible securities, and would first analyze the regulatory data to determine whether a transparency regime in the future may be appropriate for this segment of the market.
8. These estimates are derived from data sourced from Bloomberg, as are other estimates and figures in the Economic Impact Assessment, unless otherwise noted. The \$8.4 trillion in U.S. corporate debt does not include debt securities defined as money market instruments by Rule 6710(o); these money market instruments are debt securities that, at issuance, have a maturity of one calendar year or less.
9. The estimates for U.S. Government (U.S. Treasury and agencies) issuance amounts are derived from data sourced from Securities Industry and Financial Markets Association (SIFMA).
10. *See generally, e.g.*, Douglas Cumming et al., *Exchange Trading Rules and Stock Market Liquidity*, 99 J. Fin. Econ. 651 (2011) (discussing the impact of trading rules on liquidity in the equity markets); Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. Fin. Econ. 207 (2009) (discussing the correlation between public enforcement of securities laws and a number of market indicators, including trading volume and capital formation).
11. As noted in footnote 7, *supra*, if FINRA proceeds with the proposal, FINRA will analyze the regulatory data to determine whether a transparency regime in the future may be appropriate for this segment of the market.

19-25

July 26, 2019

Attachment A

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

6000. QUOTATION, ORDER, AND TRANSACTION REPORTING FACILITIES

6700. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)

6710. Definitions

The terms used in this Rule 6700 Series shall have the same meaning as those defined in the FINRA By-Laws and rules unless otherwise specified. For the purposes of this Rule 6700 Series, the following terms have the following meaning:

(a) “TRACE-Eligible Security” means a debt security that is United States (“U.S.”) dollar-denominated and is: (1) 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 Securities Act Rule 144A; (2) issued or guaranteed by an Agency as defined in paragraph (k) or a Government-Sponsored Enterprise as defined in paragraph (n); [or] (3) a U.S. Treasury Security as defined in paragraph (p); or (4) a Foreign Sovereign Debt Security as defined in paragraph (jj). “TRACE-Eligible Security” does not include a debt security that is [issued by a foreign sovereign or] a Money Market Instrument as defined in paragraph (o).

(b) through (ii) No Change.

(jj) “Foreign Sovereign Debt Security” means a debt security issued or guaranteed by the government of a foreign country, any political subdivision of a foreign country, or a supranational entity.

6730. Transaction Reporting

(a) When and How Transactions are Reported

Each member that is a Party to a Transaction in a TRACE-Eligible Security must report the transaction. A member must report a transaction in a TRACE-Eligible Security as soon as practicable, but no later than within 15 minutes of the Time of Execution, except as otherwise specifically provided below. Transactions not reported within the specified timeframe will be designated as “late.” A member must transmit the report to TRACE during TRACE System Hours.

(1) through (3) No Change.

(4) Reporting Requirements — U.S. Treasury Securities and Foreign Sovereign Debt Securities

Transactions in U.S. Treasury Securities and Foreign Sovereign Debt Securities must be reported as provided in this paragraph (a)(4).

(A) General Reporting Requirements

Transactions [in U.S. Treasury Securities] executed on:

(i) a business day at or after 12:00:00 a.m. Eastern Time through 5:00:00 p.m. Eastern Time must be reported the same day during TRACE System Hours;

(ii) a business day after 5:00:00 p.m. Eastern Time but before the TRACE system closes must be reported no later than the next business day (T + 1) during TRACE System Hours, and, if reported on T + 1, designated “as/of” and include the date of execution; or

(iii) a business day at or after 6:30:00 p.m. Eastern Time through 11:59:59 p.m. Eastern Time, or a Saturday, a Sunday, a federal or religious holiday or other day on which the TRACE system is not open at any time during that day (determined using Eastern Time) must be reported the next business day (T + 1) during TRACE System Hours, designated “as/of” and include the date of execution.

(5) through (7) No Change.

(b) through (f) No Change.

6750. Dissemination of Transaction Information

(a) through (b) No Change.

(c) Transaction Information Not Disseminated

FINRA will not disseminate information on a transaction in a TRACE-Eligible Security that is:

(1) through (3) No Change.

(4) a Securitized Product that is: a CMBS; a CDO; or a CMO if the CMO transaction value is \$1 million or more (calculated based upon original principal balance) and the transaction does not qualify for periodic dissemination under paragraph (b) above, except as may be otherwise provided in Rule 7730; [or]

(5) a U.S. Treasury Security[.]; or

(6) a Foreign Sovereign Debt Security.
