

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-56709; File No. SR-FINRA-2007-007)

October 26, 2007

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Granting Approval of Proposed Rule Change to Exempt from TRACE Reporting Transactions in TRACE-Eligible Securities Resulting from Certain Derivative-Related Transactions

On August 10, 2007, the Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) 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 to exempt from reporting to the Trade Reporting and Compliance Engine (“TRACE”) transactions in TRACE-eligible securities resulting from the exercise or settlement of an option or a similar instrument, or the termination or settlement of a credit default swap (“CDS”), other types of swap, or a similar instrument (collectively, “Derivative-Related Transactions”).<sup>3</sup> The Commission published the proposed rule change for comment in the Federal Register on September 21, 2007.<sup>4</sup> The Commission received no comments on the proposed rule change. 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> On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD’s Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Securities Exchange Act Release No. 56146 (July 26, 2007), 72 FR 42190 (August 1, 2007).

<sup>4</sup> See Securities Exchange Act Release No. 56439 (September 13, 2007), 72 FR 54087.

As described above, FINRA proposed to amend its Rules to exempt transactions in TRACE-eligible securities<sup>5</sup> that are Derivative-Related Transactions from the TRACE reporting requirements.<sup>6</sup> FINRA believes that Derivative-Related Transactions should be exempt from TRACE reporting requirements because the information regarding price (and yield) being reported to FINRA and disseminated to the public does not reflect a currently negotiated transaction price. Further, FINRA believes that reporting and dissemination of certain Derivative-Related Transactions does not foster price discovery and may contribute to investor confusion, which FINRA believes is consistent with previously recognized rationale for exempting certain transactions from trade reporting and dissemination. FINRA noted in its proposal that, historically, purchases and sales of equity securities that occurred as a result of the exercise of an over-the-counter option were subject to a similar exemption and were not required to be reported to FINRA.<sup>7</sup>

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities association.<sup>8</sup> In particular, the Commission believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act,<sup>9</sup> which requires, among other things, that FINRA rules be

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<sup>5</sup> See NASD Rule 6210 for definition of “TRACE-eligible security.”

<sup>6</sup> The TRACE reporting requirement does not exist in connection with any cash-settled derivative, even if the derivative relates to one or several securities that are TRACE-eligible securities.

<sup>7</sup> But see Securities Exchange Act Release No. 53977 (June 12, 2006), 71 FR 34976 (June 16, 2006) (requiring members to report equity trades resulting from the exercise of a physically settled option for purposes of fee calculation, but not for transparency purposes).

<sup>8</sup> In approving this rule, the Commission notes that it has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>9</sup> 15 U.S.C. 78o-3(b)(6).

designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. FINRA's proposal will relieve its members of the administrative burdens of reporting transactions in TRACE-eligible securities resulting from Derivative-Related Transactions. The Commission agrees with FINRA that requiring members to report such transactions does little to enhance market transparency, because the price of the TRACE-eligible security in this case has been previously negotiated and does not reflect the present market value. The Commission notes that it previously has approved similar proposals that exclude from trade reporting obligations “transactions effected upon the exercise of an option or any other right to acquire securities at a preestablished consideration unrelated to the current market.”<sup>10</sup>

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>11</sup> that the proposed rule change (SR-FINRA-2007-007), be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>10</sup> See Securities Exchange Act Release No. 30569 (April 10, 1992), 57 FR 13396, n.5 (April 16, 1992) (SR-NASD-91-50).

<sup>11</sup> 15 U.S.C. 78s(b)(2).

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