

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59768; File No. SR-FINRA-2009-004)

April 14, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval to Proposed Rule Change, as Modified by Amendment No. 1, to Expand the Definition of "TRACE-Eligible Security"

I. Introduction

On February 11, 2009, the Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a the 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")¹ and Rule 19b-4 thereunder,² a proposed rule change to expand the definition of "TRACE-eligible security" in FINRA Rule 6710(a). The proposed rule change was published for comment in the Federal Register on March 11, 2009.³ The Commission received two comments on the proposal.⁴ On April 9, 2009, FINRA filed Amendment No. 1 to the proposed rule change, in which FINRA also responded to the comments.⁵ The Commission is publishing this notice and order to solicit comments on Amendment No. 1 and to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 59519 (March 5, 2009), 74 FR 10630 ("Notice").

⁴ See letter from Beth N. Lawson, The Nelson Law Firm, LLC, to Elizabeth M. Murphy, Secretary, Commission, dated March 31, 2009 ("Nelson Letter"); letter from Sean C. Davy, Managing Director, Securities Industry and Financial Markets Association ("SIFMA"), to Elizabeth M. Murphy, Secretary, Commission, dated March 31, 2009 ("SIFMA Letter").

⁵ See infra Section III.

II. Description of the Proposed Rule Change

The current definition of "TRACE-eligible security" in Rule 6710(a) was adopted in 2002 and has not been amended. FINRA generally believes that this definition is sufficiently broad to require the reporting of, and provide price transparency for, a substantial portion of corporate debt securities that are eligible for public sale. However, FINRA has identified several situations where corporate debt securities that are eligible for public sale in the secondary market are trading without TRACE price transparency. According to FINRA, such securities are in many cases "exempted securities" under Section 3 of the Securities Act.⁶ For example, debt securities that are issued subject to the jurisdiction and approval of a court of competent jurisdiction in insolvency matters might be eligible for public sale but not TRACE-eligible because they are not registered under the Securities Act.⁷ In addition, debt securities issued as part of an issuer exchange offer effected pursuant to Section 3(a)(9) of the Securities Act⁸ and those issued by a bank or other financial institutions under Section 3(a)(2) of the Securities Act⁹ generally are not subject to TRACE reporting and dissemination for this reason.

Therefore, FINRA has proposed to amend Rule 6710(a), the definition of "TRACE-eligible security," by eliminating the requirement that such securities be "(1) registered under the

⁶ 15 U.S.C. 77c.

⁷ According to FINRA, if an insolvent corporation is reorganized under Chapter 11 of the U.S. Bankruptcy Code, new debt securities are often issued. The issuance is subject to the approval of the trustee and the securities are not required to be registered under the Securities Act. See 11 U.S.C. 101 et seq.

⁸ 15 U.S.C. 77c(a)(9). For example, an issuer may exchange an issue of corporate debt securities that are registered under the Securities Act (and subject to both TRACE reporting and dissemination) for new securities that are not registered in reliance upon Section 3(a)(9), which permits such exchanges without registration of the new securities. Although the exchanged security was TRACE-eligible, the new security is not because it is not registered, as required by existing FINRA Rule 6710(a).

⁹ 15 U.S.C. 77c(a)(2).

Securities Act; or (2) issued pursuant to Section 4(2) of the Securities Act and purchased or sold pursuant to Securities Act Rule 144A." This change would expand TRACE eligibility to include additional corporate debt securities that are eligible for public sale, and may have participation by retail investors. Moreover, FINRA notes that its obligation to conduct surveillance in the corporate bond market is not limited to transactions in securities that are registered under the Securities Act, and that its equity trade reporting rules generally apply to any equity securities eligible for public sale and do not consider registration a factor. FINRA believes that expanding TRACE eligibility in this manner "is vital to its mandate to regulate the market, to promote market integrity and to protect investors."¹⁰

FINRA also has proposed to add the phrase "and, if a 'restricted security' as defined in Securities Act Rule 144(a)(3)" in place of the deleted language discussed in the preceding paragraph. Thus, if a security were a restricted security, it would be TRACE-eligible if it were sold pursuant to Rule 144A under the Securities Act¹¹ (assuming it meets the other requirements for TRACE eligibility). The current definition of TRACE-eligible security requires transaction reporting for some but not all of the large market in corporate debt securities that are restricted securities and sold to qualified institutional buyers ("QIBs")¹² in transactions effected pursuant to Rule 144A. Although a significant number of restricted securities sold in Rule 144A transactions are preceded by an offering that is exempt under Section 4(2) of the Securities Act, the limitation in the current definition excludes other Rule 144A transactions that FINRA believes should be reported. Consequently, FINRA proposed to amend Rule 6710(a) to include as TRACE eligible a restricted security if it is "sold pursuant to Securities Act Rule 144A."

¹⁰ Notice, 74 FR at 10631.

¹¹ 17 CFR 230.144A.

¹² See 17 CFR 230.144A(a)(1) (defining QIB).

III. Summary of Comments and Amendment No. 1

The Commission received two comments on the proposed rule change.¹³ One commenter expressed general support for FINRA's efforts to broaden the range of securities that are subject to TRACE reporting and thus to increase price transparency in the corporate bond market generally. In addition, the commenter argued that the TRACE rules should be amended to eliminate from FINRA's dissemination protocols the "volume caps" used when disseminating information on transactions above a certain size.¹⁴ FINRA declined to respond to that comment because it is not related to the proposed rule change.

Another commenter argued that FINRA has "not provided any direction or clarity regarding the operational requirements" of reporting certain Regulation S¹⁵ transactions that have not been assigned a CUSIP number. The commenter also expressed concerns that firms have not been able to assess the system changes necessary to comply with the proposed rule change, and therefore are unable to comment on what would be an appropriate implementation timeline.¹⁶ In addition, the commenter suggested that FINRA consider implementing a process for obtaining identifier information for securities (such as many Regulation S securities) for which no identifying information has previously been reported under FINRA Rule 6760, and requested that FINRA provide firms a reasonable grace period to report transactions in such securities.¹⁷

¹³ See supra note 4.

¹⁴ See Nelson Letter at 1.

¹⁵ 17 CFR 230.901-905.

¹⁶ See SIFMA Letter at 1.

¹⁷ See id. at 2.

In response, FINRA stated that the proposed rule change does not require members to report bona fide off-shore Regulation S transactions to TRACE. If a security that is the subject of a Regulation S offering were subsequently part of a U.S. transaction that is required to be reported to TRACE, such securities generally would be assigned CUSIPs. FINRA stated, however, that it would provide guidance on reporting obligations if certain TRACE-eligible securities had for some reason not been assigned a CUSIP number. Finally, FINRA stated that it would establish an effective date that will provide firms sufficient time to make any minor operational enhancements needed to report these types of transactions.¹⁸

FINRA also responded to the commenter's request for a grace period to report transactions in securities offered under Regulation S and other securities that a member finds are not in the TRACE system at the time the member is required to report a transaction. FINRA responded that members that are a party to a transaction in a TRACE-eligible security are required to report the transaction, and if the CUSIP for a TRACE-eligible security is not in the TRACE system, a member must notify FINRA Operations promptly, provide the CUSIP and other identifying information, and thereafter report the member's transaction. FINRA stated that it takes into account a delay in reporting that may occur if a member, upon trying to report a transaction, determines that the member first must notify FINRA Operations and provide the CUSIP and other identifying information for the security to be added to TRACE. Rather than supporting the proposed grace period, FINRA advises members to maintain a record of any notifications the member provides to FINRA Operations, which FINRA would view as a mitigating factor in reviewing the transaction report(s) in such security of members providing notification. FINRA further suggested that, where there has been prompt notification and

¹⁸ See Amendment No. 1 at 4.

reporting of a security as soon as possible after the security is included in TRACE, FINRA generally would not include such trades in any regulatory inquiry directed to the firm and that, generally, it would be unlikely for such late trades to form the factual basis for formal or informal action, absent other regulatory concerns or violations.¹⁹

Also in Amendment No. 1, FINRA deleted certain language from its Form 19b-4 wherein it discussed the purpose of the proposed rule change.²⁰ These revisions are non-substantive and do not affect the proposed rule text.

IV. Discussion

After carefully considering the proposal and the comments submitted, 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.²¹ In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,²² which requires, among other things, that FINRA rules must 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. The Commission does not believe that the comments raise any issue that would preclude approval of the proposal.

The Commission believes that it is reasonable and consistent with the Act for FINRA to broaden the definition of "TRACE-eligible security" in the manner set forth in the proposal. The

¹⁹ FINRA noted, however, that providing notification to FINRA Operations would not be viewed as a mitigating factor or circumstance during any review of late trade reports, if FINRA determines that the member was obligated under Rule 6760 to provide notice to FINRA Operations at or prior to the initial issuance of the TRACE-eligible security. See Amendment No. 1 at 4.

²⁰ See id. at 5.

²¹ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²² 15 U.S.C. 78o-3(b)(6).

larger universe of transactions in corporate debt securities that are subject to TRACE reporting should result in greater transparency for market participants and the public. Including in the audit trail additional corporate debt securities that are eligible for public sale (and that otherwise meet the standards for TRACE eligibility) should enhance FINRA's surveillance efforts, as FINRA's obligation to conduct surveillance in the corporate bond market is not limited to transactions in securities that are registered under the Securities Act.

In addition, the Commission believes that amending the definition of "TRACE-eligible security" in Rule 6710(a) to include all restricted securities sold pursuant to Rule 144A, rather than only those preceded by an offering exempt pursuant to Securities Act Section 4(2), is a reasonable expansion of TRACE reporting. The additional transaction data will allow FINRA to obtain a more complete audit trail of transactions in corporate debt securities.

The Commission finds good cause for approving the proposed rule change, as modified by Amendment No. 1 thereto, before the thirtieth day after the date of publication of notice of filing of Amendment No. 1 in the Federal Register. Amendment No. 1 makes only minor non-substantive changes to the proposal, which otherwise was subject to a full comment period. Therefore, the Commission finds good cause, consistent with Section 19(b)(2) of the Act, to approve the proposal, as modified by Amendment No. 1, on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-FINRA-2009-004 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2009-004. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2009-004 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²³ that the proposed rule change (File No. SR-FINRA-2009-004), as modified by Amendment No. 1 thereto, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant delegated authority.²⁴

Florence E. Harmon
Deputy Secretary

²³ 15 U.S.C. 78s(b)(2).

²⁴ 17 CFR 200.30-3(a)(12).