Market Regulation Priorities: Detecting and Preventing Misconduct
Wednesday, May 23
8:30 a.m. – 9:30 a.m.

This session provides updates on market regulation priorities, including current initiatives and rulemaking. FINRA panelists share thoughts on equities, options and fixed income compliance programs.

Moderator: Duer Meehan
Vice President, Market Regulation
FINRA Office of Market Regulation

Panelists: Gene DeMaio
Senior Vice President
FINRA Market Regulation

Jon Kroeper
Executive Vice President, Quality of Markets
FINRA Quality of Markets

Robert Marchman
FINRA Fellow
FINRA Enforcement
Market Regulation Priorities: Detecting and Preventing Misconduct Panelist Bios:

Moderator:

Duer Meehan joined FINRA in August 2012 as the Deputy Director of the Department of Market Regulation. In addition he helps lead FINRA’s participation on the SRO Consortium that is developing the Consolidated Audit Trail NMS Plan. Prior to FINRA, Mr. Meehan worked in PwC’s Financial Services Regulatory Practice, where he worked on engagements with broker-dealers, asset managers, exchanges, a clearing agency, a trade monitoring vendor, and a rating agency. He helped these organizations with front-to-back regulatory reviews, regulatory governance assessments, controls related to quantitative high-frequency trading, the prevention of insider trading, regulatory reporting, the implementation of new regulations, the enhancement of trade surveillance tools, and the management of conflicts of interest. Prior to PwC, Mr. Meehan was the Associate Director of the Office of Market Oversight in the SEC’s Office of Compliance Inspections and Examinations. In this role, Mr. Meehan was responsible for supervising the SEC’s oversight inspections of the self-regulatory organizations’ regulatory programs with respect to trading, including their surveillance, examination, and disciplinary programs. His group was also responsible for examinations of broker-dealers’ trading practices and operations, including alternative trading systems. In addition, he oversaw the SEC's examinations of credit rating agencies and managed the transfer agent examination program as well as participating in examinations of investment advisers. Before becoming Associate Director, Mr. Meehan was an Assistant Director in OCIE’s broker-dealer group, managing examinations addressing multiple issues, including equity and debt securities trading and sales practices, supervision, internal controls, and anti-money laundering. In addition, his responsibilities included helping manage the SEC's national examination program for broker-dealers. Mr. Meehan has also served as an adjunct professor of law at Georgetown University Law Center, teaching the regulation of securities trading. His experience prior to the SEC includes implementing trading systems at Bloomberg.

Panelists:

Gene DeMaio is Senior Vice President in FINRA’s Market Regulation Department where he manages the Options Regulation and Trading and Financial Compliance Examinations programs. Prior to joining FINRA, Mr. DeMaio was an Options Market Maker at the American Stock Exchange, and earlier worked as an attorney at the law firm of Kord Lagemann where he represented complainants in securities arbitration disputes. Mr. DeMaio is a graduate of Fordham Law and earned his LL.M at New York University.

Jon Kroeper is Executive Vice President of the Quality of Markets Section of FINRA’s Market Regulation Department. The Quality of Markets Section is responsible for the conduct of post-trade surveillance and investigations related to data integrity, market conduct rules, and trading-manipulation matters in the U.S. equity and fixed income markets regulated by FINRA as a self-regulatory organization and as a provider of regulatory services to other U.S. SROs. Prior to joining FINRA’s predecessor NASD in early 2007, Mr. Kroeper served as Counsel to U.S. Securities and Exchange Commission Chairman Chris Cox in 2006 and 2007, and Counsel to Commissioner Paul S. Atkins in 2005. From 2000 to 2005, Mr. Kroeper was First Vice President and Associate General Counsel for Instinet Group Incorporated. Mr. Kroeper began his career at the U.S. Securities and Exchange Commission in 1994, serving as a senior counsel in the Division of Market Regulation and subsequently as Counsel to Commissioner Laura S. Unger. Mr. Kroeper received a bachelor’s degree from Georgetown University and a law degree, cum laude, from Chicago-Kent College of Law.

Robert A. Marchman joined FINRA in June 2010 as Executive Vice President and Head of the Market Regulation Department’s Legal Group (the Group prosecutes violations of market rules and federal securities laws such as the recent significant disciplinary actions involving manipulative high-frequency trading activity). Mr. Marchman, prior to joining FINRA, worked at New York Stock Exchange Regulation and during his tenure there headed the Market Surveillance Division, the Enforcement Division and the Regulatory Risk Group. While at NYSE, Mr. Marchman directed several high profile and significant securities regulation disciplinary actions including the research analysts conflict of interest and specialist trading ahead cases. Prior to joining the NYSE in 1989, Mr. Marchman was a branch chief in the U.S. Securities and Exchange Commission's Division of Enforcement in Washington, D.C. In addition to his securities regulation responsibilities, Mr. Marchman served as Chairman of NYSE Diversity Council from
its inception in 1999 until his departure from the NYSE. At FINRA, Mr. Marchman serves on the company’s Executive Diversity Leadership Council (whose members include FINRA’s Chairman/CEO) as well as the Executive Sponsor of the FINRA’s Women’s Network Employee Resource Group. Mr. Marchman is a magnacum laudegraduate of Allegheny College, where he was inducted into Phi Beta Kappa and received his J.D. from the University of Pennsylvania. In addition, Mr. Marchman, the first African-American Executive Vice President at the NYSE, attended Harvard Business School’s Program for Management Development. Mr. Marchman’s involvement in civic affairs includes Board membership service with Operation HOPE, PFLAG, The Community Coalition on Race, Allegheny College, the University Of Pennsylvania Law School Board Of Managers and a Lector at OLS. He is also the recipient of numerous business and community service awards including being named as an honoree in Savoy Magazine’s 2016 List of Top 100 African-Americans in Corporate America and the recipient of the 2016 Rainbow PUSH/Wall Street Project “Diversity and Inclusion Financial Industry Champion Award”.

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2018 FINRA Annual Conference
May 21 – 23, 2018 • Washington, DC

Market Regulation Priorities:
Detecting and Preventing Misconduct
Panelists

Moderator
- Duer Meehan, Vice President, Market Regulation, FINRA Office of Market Regulation

Panelists
- Gene DeMaio, Senior Vice President, FINRA Market Regulation
- Jon Kroeper, Executive Vice President, Quality of Markets, FINRA Quality of Markets
- Robert Marchman, FINRA Fellow, FINRA Enforcement
To Access Polling

- Under the “Schedule” icon on the home screen,
- Select the day,
- Choose the Market Regulation Priorities: Detecting and Preventing Misconduct session,
- Click on the polling icon:
Polling Question 1

1. What is your firm size?
   a. Small (1-150 RRs)
   b. Medium (151-500 RRs)
   c. Large (501+ - RRs)
2. What is your biggest area of concern within your regulatory department?
   a. Supervisory Procedures
   b. Effectiveness of internal surveillance reports
   c. Reporting deficiencies
   d. Nothing—we do everything well!
Polling Question 3

3. Who in the audience has been subject to an examination by TFCE Equities, Options, or FINOP?
   a. Yes
   b. No
Polling Question 4

4. How willing are you to reach out to Market Regulation staff with a question regarding an outstanding review?

a. Willing
b. Somewhat willing
c. Not very willing
d. Happy to let sleeping dogs lie.
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Resources

FINRA Resources

- FINRA Webpage: Equity Market Surveillance Today and the Path Ahead
  www.finra.org/newsroom/speeches/092017-equity-market-surveillance-today-and-path-ahead

- FINRA Webpage: Order Routing Conflicts
  www.finra.org/industry/order-routing-conflicts

- Phone-In Workshop and WebEx Presentation Recording: Cross-Market Equity Supervision Report Cards

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Pricing Disclosure in the Fixed Income Markets

SEC Approves Amendments to Require Mark-Up/Mark-Down Disclosure on Confirmations for Trades With Retail Investors in Corporate and Agency Bonds

Effective Date: May 14, 2018

Executive Summary

The Securities and Exchange Commission (SEC) approved amendments to FINRA Rule 2232 (Customer Confirmations) that require member firms to disclose additional transaction-related information to retail customers for trades in certain fixed income securities. Specifically, amended Rule 2232 requires a member to disclose the amount of mark-up or mark-down it applies to trades with retail customers in corporate or agency debt securities if the member also executes an offsetting principal trade in the same security on the same trading day. The amended rule also requires members to disclose two additional items on all retail customer confirmations for corporate and agency debt security trades: (1) a reference, and a hyperlink if the confirmation is electronic, to a web page hosted by FINRA that contains publicly available trading data for the specific security that was traded, and (2) the execution time of the transaction, expressed to the second. These amendments will become effective on May 14, 2018.

The amended rule text is available on FINRA’s website.

Questions regarding this Notice should be directed to:

- Patrick Geraghty, Vice President, Market Regulation, at (240) 386-4973 or Patrick.Geraghty@finra.org;
- Cynthia Friedlander, Director, Fixed Income Regulation, Regulatory Operations, at (202) 728-8133 or Cynthia.Friedlander@finra.org; or
- Alex Ellenberg, Associate General Counsel, Office of General Counsel, at (202) 728-8152 or Alexander.Ellenberg@finra.org.
Background and Discussion

Pursuant to SEA Rule 10b-10, firms currently are required to provide transaction cost information when acting as principal with customers for equity trades; however, no comparable requirement had existed for bond trades. As part of an initiative to provide retail fixed income investors with additional information about the costs of their transactions, FINRA filed proposed amendments to Rule 2232 to require enhanced transaction cost and related information on customer confirmations.¹

FINRA’s amendments to Rule 2232 were developed as the result of a multi-year process during which FINRA twice solicited feedback on related proposals.² Throughout the process, FINRA worked closely with the Municipal Securities Rulemaking Board (MSRB) to develop similar rules, as appropriate, to ensure consistent disclosures to customers across debt securities and to reduce the operational burdens for firms that trade multiple fixed income securities. The SEC approved FINRA’s amendments to Rule 2232, as well as the MSRB’s parallel confirmation disclosure proposal, on November 17, 2016.³

Mark-Up Disclosure Requirements

When Disclosure is Required

New Rule 2232(c) requires members to disclose to a non-institutional customer⁴ the amount of mark-up or mark-down⁵ the customer paid for a trade in a corporate or agency debt security,⁶ if the member also executes one or more offsetting principal trades in the same security on the same trading day which in the aggregate meet or exceed the size of the customer trade.

The following example explains how the “offsetting” language that describes when disclosure is triggered under the rule is intended to operate: If a member purchases 100 bonds at 9:30 a.m., and then sells to three customers, who each buy 50 bonds in the same security on the same day, without purchasing any more of the bonds, the rule requires mark-up disclosure on two of the three trades, since one of the trades would need to be satisfied out of the member’s prior inventory, or its short position, rather than offset by the member’s same-day principal transaction.⁷

FINRA notes that a disclosure obligation under Rule 2232(c) could be triggered by an offsetting principal trade executed by a member’s affiliate. Specifically, if a member’s offsetting principal trade is executed with a broker-dealer affiliate and did not occur at arm’s length,⁸ the member is required to “look through” to the time and terms of the affiliate’s trade to comply with the rule.
New Rule 2232(d) contains two exceptions to the mark-up disclosure requirements of Rule 2232(c). First, mark-up disclosure is not triggered by principal trades that a member executes on a trading desk that is functionally separate from a trading desk that executes customer trades, provided the member maintains policies and procedures reasonably designed to ensure that the functionally separate trading desk has no knowledge of the customer trades. Second, mark-up disclosure does not need to be provided for bonds that are acquired by a member in a fixed-price offering and sold to non-institutional customers at the same offering price on the same day the member acquired the bonds.

Members may develop reasonable policies and procedures to identify and account for offsetting trades that trigger the disclosure obligations of Rule 2232(c). Members may also choose to provide mark-up disclosure more broadly, for example to all trades with retail customers.

**Methods to Calculate and Disclose Mark-Ups**

Members need to calculate the mark-up that is disclosed on a customer confirmation from the prevailing market price (PMP) for the security, consistent with existing FINRA Rule 2121 (Fair Prices and Commissions) and the supplementary material thereunder, particularly Supplementary Material .02 (Additional Mark-Up Policy for Transactions in Debt Securities, Except Municipal Securities). Members may base their mark-up calculations for confirmation disclosure purposes on the information they have available to them as a result of reasonable diligence at the time they input relevant transaction information into systems to generate confirmations. In other words, amended Rule 2232 does not prevent members from maintaining real-time, intra-day confirmation generation processes. Members can engage third-party service providers to facilitate mark-up disclosure consistent with Rule 2232; however, members retain compliance responsibility and are expected to exercise due diligence and oversight over third party relationships. Members may also choose to automate their mark-up disclosure calculation process according to reasonable, consistently applied policies and procedures, if consistent with Rule 2121.

Where mark-up disclosure is provided on customer confirmations, Rule 2232(c) requires firms to express the disclosed mark-up as both a dollar amount and a percentage of PMP. Members may include accompanying language to provide explanation of mark-up-related concepts, or a member’s particular methodology for calculating mark-ups, provided such statements are accurate. However, members may not label mark-ups as “estimated” or “approximate” figures.
Requirement to Disclose a Reference or Link to Security-Specific Trade Data

For all trades with non-institutional customers in corporate and agency debt securities, whether mark-up disclosure is triggered or not, new Rule 2232(e) requires members to provide a reference, and a hyperlink if the confirmation is electronic, to a web page hosted by FINRA that contains TRACE publicly available trading data for the specific security that was traded, along with a brief description of the type of information available on that page.¹²

FINRA noted during the rulemaking process that it was working to develop a short Uniform Resource Locator (URL) to try to mitigate the operational burdens of this requirement.¹³ Based on a variety of factors, including logistical concerns such as length of the link and space available on confirmations, discussions with member firms, as well as research into investor preferences, FINRA has established the following URL: http://bondfacts.fnra.org/<CUSIP>. Paper confirmations would be required to include this URL in print form; electronic confirmations would be required to include this URL as a hyperlink to the web page.

FINRA believes this URL is consistent with the principles it discussed during the rulemaking process, most notably, the need to develop a short, uniform link template that could be subject to automation by members. FINRA also notes that this URL is similar in length and convention to the URL that the MSRB will require for confirmations for transactions in municipal securities with retail customers. Should members wish to provide feedback on the URL that FINRA has chosen, FINRA will consider this input.

Time of Execution Disclosure Requirement

Rule 2232(e) further requires members to disclose the time of execution, expressed to the second, for all non-institutional customer trades in corporate and agency debt securities. As with the URL requirement, trade time disclosure is required even in cases where mark-up disclosure is not triggered. Providing customers the time of execution will assist them in identifying their individual trade when accessing the TRACE publicly available information.
Implementation Period

The effective date for the above-described amendments to Rule 2232 is May 14, 2018. This effective date, which is eighteen months from when the amendments were approved by the SEC, is the same as the effective date for the MSRB's parallel confirmation disclosure requirements.14

FINRA recognizes members may still have specific implementation questions and remains committed to working closely with the industry and MSRB during the implementation period to issue further guidance as necessary.

Endnotes


2. See Regulatory Notice 14-52 (November 2014) and Regulatory Notice 15-36 (15-36). The proposals contained in these Regulatory Notices, and how they differ from the amendments to Rule 2232 that FINRA ultimately filed with the SEC, are discussed in the proposal, supra note 1.


4. The term “non-institutional customer” is defined in Rule 2232(f)(4) to mean a customer with an account that is not an institutional account. The term “institutional account” is defined in Rule 4512(c) to mean an account of “(1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million.”

5. For ease of reference, unless otherwise noted, the term “mark-up” refers to mark-ups and mark-downs, collectively.

6. The terms “corporate debt security” and “agency debt security” are defined in Rules 2232(f)(1) and (2), respectively.
7. See Approval Order, supra note 3, at 84663 (discussing FINRA’s response to comments submitted to the SEC concerning the proposed amendments.)

8. The term “arms-length transaction” is defined in Rule 2232(f)(3) to mean “a transaction that was conducted through a competitive process in which non-affiliate firms could also participate, and where the affiliate relationship did not influence the price paid or proceeds received by the member.” FINRA has noted that as a general matter, it expects the competitive process used in an “arms-length” transaction to be one in which non-affiliates have frequently participated. See Approval Order, supra note 3, at 84662 n. 43.

9. For example, this exception allows an institutional desk within a firm to service an institutional customer without necessarily triggering the disclosure requirement for an unrelated trade performed by a separate retail desk within the firm. However, given the “no knowledge” provision of this exception, a firm could not avoid triggering the mark-up disclosure requirement if trades executed on an institutional desk were used to source transactions at the retail desk. See Proposal, supra note 1, at 55502.

10. Specifically, mark-ups must be disclosed on confirmations as a total dollar amount (i.e., the dollar difference between the customer’s price and the security’s PMP), and as a percentage amount (i.e., the mark-up’s percentage of the security’s PMP).

11. See Approval Order, supra note 3, at 84671.

12. Each security-specific web page will include information about the prices of other transactions in the same bond, as well as additional market data and educational material that FINRA believes will be useful to retail investors.

13. See Approval Order, supra note 3, at 84667 (citing to FINRA’s response to comments).

Executive Summary

Beginning July 10, 2017, FINRA member firms must begin reporting transactions in U.S. Treasury Securities to FINRA via TRACE. This Notice describes the scope of the term “U.S. Treasury securities” for purposes of the new reporting requirement; the specific transactions in U.S. Treasury securities that are reportable and those that are exempt from the reporting requirement; and the information that must be reported to TRACE when reporting transactions in U.S. Treasury securities, including a new trade indicator and two new modifiers. FINRA is publishing technical specifications concurrently with this Notice, which are available on FINRA’s website. At this time, FINRA will not disseminate information on transactions in U.S. Treasury securities and will not charge transaction-level fees on transactions in U.S. Treasury securities reported to TRACE.

The new rule text is available in the online FINRA Manual on FINRA’s website.

Questions concerning this Notice should be directed to:

- Chris Stone, Vice President, Transparency Services, at (202) 728-8457;
- Patrick Geraghty, Vice President, Market Regulation, at (240) 386-4973; or
- Brant Brown, Associate General Counsel, Office of General Counsel, at (202) 728-6927.
Background & Discussion

Background

The market in debt securities issued by the U.S. Department of the Treasury (Treasury Department), or “Treasuries,” is the deepest and most liquid government securities market in the world. Treasuries—such as bills, notes and bonds—are debt obligations of the U.S. government, and because these debt obligations are backed by the “full faith and credit” of the government, and thus by its ability to raise tax revenues and print currency, Treasuries are generally considered the safest of all U.S. investments. Treasuries are traded by broker-dealers that are FINRA members as well as commercial bank dealers and principal trading firms that are not registered as broker-dealers with the SEC or members of FINRA; however, there is not currently a complete public repository or audit trail for information on transactions in Treasuries.

In response to unexplained volatility in the U.S. Treasury market in October 2014, an interagency working group (IAWG) led by the Treasury Department issued a detailed joint staff report (JSR) on July 13, 2015, that included a set of preliminary findings on the volatility, described the current state of the U.S. Treasury market, and proposed a series of four “next steps” in understanding the evolution of the U.S. Treasury market.1 Included among these “next steps” was an assessment of the data available to regulators and to the public regarding the cash market for Treasuries.

Following publication of the JSR, on January 19, 2016, the Treasury Department published a Request for Information (RFI) seeking public comment on structural changes in the U.S. Treasury market and their implications for market functioning.2 The RFI included four sections, each of which expanded upon one of the four “next steps” identified in the JSR, and each section included numerous questions for public consideration and comment. Included within the RFI were numerous questions requesting comment on official sector access to data regarding the cash market for Treasuries and whether dissemination of U.S. Treasury market transaction data to the public would be beneficial.

Following receipt and review of the comment letters, the Treasury Department and the SEC announced that “they are working together to explore efficient and effective means of collecting U.S. Treasury cash market transaction information,” and as part of this effort, they requested that FINRA “consider a proposal to require its member brokers and dealers to report Treasury cash market transactions to a centralized repository.”3 The Treasury Department noted that it “will continue working with other agencies and authorities to develop a plan for collecting similar data from institutions who actively trade U.S. Treasury securities but are not FINRA members.”4
In response to this request, on July 18, 2016, FINRA filed a proposed rule change to adopt new reporting requirements for transactions in U.S. Treasury securities, as defined in the TRACE Rules. The SEC approved the new requirements, which are described below, on October 18, 2016. Beginning July 10, 2017, FINRA member firms must begin reporting transactions in U.S. Treasury securities to FINRA. Firms are not required to include the two new modifiers, as applicable, in their TRACE reports for transactions in U.S. Treasury securities beginning July 10, 2017. FINRA will announce the implementation date for the new modifiers at a later date. At this time, FINRA will not disseminate information on these transactions, and FINRA will not charge fees on transactions in U.S. Treasury securities reported to TRACE.

Discussion
Below, the Notice describes:

- the scope of the term “U.S. Treasury securities” for purposes of the TRACE reporting requirement;
- the transactions in U.S. Treasury securities that are reportable and those that are exempt from the reporting requirement;
- the information that must be reported to TRACE when reporting transactions in U.S. Treasury securities, including a new trade indicator and two new modifiers; and
- the implementation schedule.

In addition to this Notice, FINRA is also publishing technical specifications describing the new reporting requirements for U.S. Treasury securities, which are available on FINRA’s website.

Scope of Securities
The TRACE Rules require the reporting of transactions in all “TRACE-eligible securities.” Under the amendments, the term “TRACE-eligible securities” now includes “U.S. Treasury securities,” which includes all securities issued by the Treasury Department with the exception of savings bonds. Consequently, the TRACE reporting requirements will apply to all marketable Treasuries, including Treasury bills, notes, bonds, and inflation-protected securities (often called “TIPS”). The new reporting requirement also applies to separate principal and interest components of a U.S. Treasury security that have been separated pursuant to the Separate Trading of Registered Interest and Principal of Securities (STRIPS) program operated by the Treasury Department.
Reportable Transactions

In general, any transaction in a TRACE-eligible security is a “reportable TRACE transaction” unless the transaction is subject to an exemption. Rule 6730(e) provides several exemptions from the TRACE trade reporting requirements for certain types of transactions. The amendments add an exemption to Rule 6730(e) for purchases of a U.S. Treasury security from the Treasury Department as part of an auction. When-issued transactions, which can take place after the Treasury Department’s announcement of an auction but before the auction and issuance of the securities, are reportable under the new reporting requirements.

As amended, Rule 6730(e) exempts an “auction transaction,” defined as the purchase of a U.S. Treasury security in an auction, from the TRACE reporting requirements. A when-issued transaction in a U.S. Treasury security must be reported to TRACE with an appropriate trade indicator, as described below. For transaction reporting purposes, reopening transactions in a U.S. Treasury security that is the subject of an auction would also be treated as “when-issued transactions.”

The amendments also codify the long-standing interpretation for all TRACE-eligible securities that repurchase and reverse repurchase transactions are not reportable to TRACE. Thus, these types of transactions, including those involving U.S. Treasury securities, are not required to be reported to TRACE.

As is currently the case with all TRACE reporting obligations, any FINRA member firm that is a “Party to a Transaction” in a TRACE-eligible security is required to report the transaction; thus, a reportable TRACE transaction in U.S. Treasury securities between two FINRA member firms must be reported by both firms. The amendments require reportable TRACE transactions in U.S. Treasury securities generally to be reported on the same day as the transaction on an end-of-day basis. Under the amendments to Rule 6730(a), reportable TRACE transactions in U.S. Treasury securities executed on 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. Transactions executed on 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. Transactions executed on a business day at or after 6:30:00 p.m. Eastern Time through 11:59:59 p.m. Eastern Time—or on 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. Firms that wish to report transactions in U.S. Treasury securities on an immediate basis may do so; however, those firms that may find it more cost effective or beneficial to report on an end-of-day basis may report pursuant to the timeframes established in Rule 6730.
Reportable Transaction Information

Rule 6730(c) lists the following transaction information that must be reported to TRACE for each reportable TRACE transaction:

1. CUSIP number or, if a CUSIP number is not available at the time of execution, a similar numeric identifier or a FINRA symbol;
2. The size (volume) of the transaction, as required by Rule 6730(d)(2);
3. Price of the transaction (or the elements necessary to calculate price, which are contract amount and accrued interest) as required by Rule 6730(d)(1);
4. A symbol indicating whether the transaction is a buy or a sell;
5. Date of trade execution (for “as/of” trades only);
6. Contra-party’s identifier (MPID, customer, or a non-member affiliate, as applicable);
7. Capacity — principal or agent (with riskless principal reported as principal);
8. Time of execution;
9. Reporting side executing broker as “give-up” (if any);
10. Contra side introducing broker in case of “give-up” trade;
11. The commission (total dollar amount);
12. Date of settlement;
13. If the member is reporting a transaction that occurred on an ATS pursuant to Rule 6732, the ATS’s separate MPID obtained in compliance with Rule 6720(c); and
14. Such trade modifiers as required by either the TRACE rules or the TRACE users guide.

The amendments apply these same information requirements to TRACE trade reports in U.S. Treasury securities; however, the amendments clarify how some of this information must be reported when the transaction involves a U.S. Treasury security. First, the amendments clarify that, because when-issued trading is based on yield rather than on price as a percentage of face or par value, the yield should be reported in lieu of the price when the transaction is a when-issued transaction, as defined in the TRACE Rules. The amendments also make clear that, as is the case whenever price is reported for a transaction executed on a principal basis, the yield reported for a when-issued transaction must include any mark-up or mark-down. If the firm is acting in an agency capacity, the total dollar amount of any commission must be reported separately.
Second, the amendments require reporting of a more precise time of execution for transactions in U.S. Treasury securities that are executed electronically. New Supplementary Material .04 to Rule 6730 requires that, when reporting transactions in U.S. Treasury securities executed electronically, firms report the time of execution to the finest increment of time captured in the firm’s system (e.g., milliseconds or microseconds) but, at a minimum, in increments of seconds. Importantly, the amendments do not require firms to update their systems to comply with a finer time increment; rather, the Supplementary Material simply requires a firm to report the time of execution to TRACE in the same time increment its system already captures.¹⁶

Finally, the amendments adopt a new trade indicator and two new trade modifiers that reflect unique attributes of the U.S. Treasury cash market. As amended, Rule 6730 includes a new trade indicator for any reportable TRACE transaction in a U.S. Treasury security that meets the definition of “when-issued transaction.” This indicator will permit FINRA to determine whether price is being reported on the transaction based on a percentage of face or par value or whether, as required for when-issued transactions, the firm is reporting the yield, and the indicator can be used to validate transactions in a U.S. Treasury security that are reported with an execution before the auction and issuance of the security have taken place.

In addition to the new indicator, the amendments to Rule 6730 require the use of two new modifiers, when applicable, to reported transactions in U.S. Treasury securities. Individual transactions in U.S. Treasury securities are often executed as part of larger trading strategies, which can result in individual transactions reported to TRACE being priced away from the current market for legitimate reasons. The amendments include two new modifiers to indicate particular transactions that are part of larger trading strategies and therefore may be executed at prices away from the market at the time of the transaction. The amendments to Rule 6730 require that firms append the following modifiers, as applicable, to trade reports for U.S. Treasury securities:

- a “B” modifier if the transaction being reported is part of a series of transactions where at least one of the transactions involves a futures contract (e.g., a “basis” trade); and
- an “S” modifier if the transaction being reported is part of a series of transactions and may not be priced based on the current market (e.g., a fixed price transaction in an “on-the-run” security as part of a transaction in an “off-the-run” security).

The “S” modifier applies more broadly than the “B” modifier in that it applies to a trade report if the transaction being reported is part of a series of transactions that could result in the reported transaction being executed away from the current market. The “S” modifier applies to a transaction in a particular strategy that meets the “S” criteria regardless of whether it is, in fact, off market and is therefore permitted when a transaction is part of a series and could be, but need not be, priced away from the market.
As noted above, because FINRA believes it may take firms more time to establish and implement a process for appending trade modifiers, the implementation date for the requirement to attach “.B” or “.S” trade modifiers, if applicable, will be announced at a later date. FINRA notes, however, that firms will be permitted to append the modifiers beginning July 10, 2017, which may help reduce potential “false positive” alerts for transactions executed at prices away from the market at the time of the transaction.

Implementation

Implementation Dates
The requirement to report transactions in U.S. Treasury securities to TRACE is being implemented in two separate phases. First, FINRA member firms must begin reporting transactions in U.S. Treasury securities on July 10, 2017. The use of the new “.B” and “.S” trade modifiers—the second phase—will not be required beginning on July 10, 2017, and FINRA will announce the implementation date at a later time. Firms are permitted to append the trade modifiers beginning on July 10, 2017.

Fees
At this time, FINRA is not charging TRACE transaction-level fees on reports for U.S. Treasury securities, and FINRA has exempted these transactions from the Trading Activity Fee.¹⁷ As in other FINRA trade reporting system contexts, re-reporting and amending of trades are captured in a firm’s error statistics published on the TRACE Report Cards even if the transactions are not considered late. However, as no transaction reporting fees are being charged for U.S. Treasury security reporting at this time, there will be no fees charged for re-reports or amendments.

CUSIP Registration
FINRA intends to register the CUSIPs for outstanding U.S. Treasury securities with TRACE so firms will not be required to do so, and CUSIPs for these securities will be included on FINRA’s daily list of reportable securities. On a going-forward basis, FINRA will register CUSIPs in U.S. Treasury securities for TRACE reporting purposes coincident with the announcement by the Treasury Department of an auction.¹⁸
Endnotes

1. See Joint Staff Report: The U.S. Treasury Market on October 15, 2014, at 7 (July 13, 2015). The IAWG consists of representatives of the Treasury Department, the Federal Reserve Board of Governors, the Federal Reserve Bank of New York, the SEC and the CFTC.

2. The RFI, which was written in consultation with the staffs of all of the agencies involved in the JSR, was published in the Federal Register on January 22, 2016. See Notice Seeking Public Comment on the Evolution of the Treasury Market Structure, 81 FR 3928 (January 22, 2016).


4. In August, the agencies in the IAWG announced that they “will continue to assess effective means to ensure that the collection of data regarding Treasury cash securities market transactions is comprehensive and includes information from institutions that are not FINRA members.” See press release, U.S. Department of the Treasury, Statement Regarding Progress on the Review of the U.S. Treasury Market Structure since the July 2015 Joint Staff Report (August 2, 2016).

5. The term “U.S. Treasury security” is defined in Rule 6710(p).


7. Unlike other Treasuries, savings bonds issued by the Treasury Department are generally non-transferable and are therefore not marketable securities purchased and sold in the secondary market. See, e.g., 31 CFR 353.15 (providing that Series EE and Series HH “[s]avings bonds are not transferable and are payable only to the owners named on the bonds, except as specifically provided in these regulations and then only in the manner and to the extent so provided”); see also 31 CFR 360.15 (establishing the same transfer provisions for Series I savings bonds).

8. Rule 6710(o) defines a “money market instrument” as “a debt security that at issuance has a maturity of one calendar year or less, or, if a discount note issued by an Agency, as defined in paragraph (k), or a Government-Sponsored Enterprise, as defined in paragraph (n), a maturity of one calendar year and one day or less.” Because money market instruments are excluded from the definition of TRACE-eligible security, the definition of “money market instrument” was amended to exclude U.S. Treasury securities, including U.S. Treasury bills, which have maturities of one year or less. See 31 CFR 356.5(a).

9. At this time, FINRA is not providing, nor requiring reporting of, factor information when reporting transactions in TIPS to TRACE.

10. The STRIPS program is a program operated by the Treasury Department under which eligible securities are authorized to be separated into principal and interest components and transferred separately. See 31 CFR 356.2; see generally 31 CFR 356.31 (providing details on how the STRIPS program works).

11. For purposes of the trade reporting rules, FINRA considers a “trade” or a “transaction” to entail a change of beneficial ownership between parties. See, e.g., Securities Exchange Act Release No. 74482 (March 11, 2015), 80 FR 13940, 13941 (March 17, 2015) (Order Approving SR-FINRA-2014-050); Trade Reporting Frequently Asked Questions, Q100.4, available at www.finra.org/industry/trade-reporting-faq#100 (defining “trade” and “transaction” for purposes of the equity trade reporting rules as a change in beneficial ownership). For this reason, although
trading a principal or interest component of a U.S. Treasury security that has been separated under the STRIPS program would constitute a reportable TRACE transaction, the act of separating or reconstituting the components of a U.S. Treasury security under the STRIPS program would not constitute a reportable TRACE transaction. Supplementary Material .05 to Rule 6730 clarifies the reporting obligations in this scenario.

12. All U.S. Treasury securities reportable to TRACE under the amendments are offered to the public by the Treasury Department through an auction process. The regulations governing this process are set forth in Part 356 of Title 31 of the Code of Federal Regulations.

13. See Reporting of Corporate and Agencies Debt Frequently Asked Questions, Question 4.6. Although repurchase and reverse repurchase transactions are structured as purchases and sales, the transfer of securities effected as part of these transactions is not made as the result of an investment decision but, rather, is more akin to serving as collateral pledged as part of a secured financing. Consequently, repurchase and reverse repurchase transactions are economically equivalent to financings, and the pricing components of these transactions are typically not the market value of the securities.

14. See Rule 6730(a), (b)(1). The term “party to a transaction” is defined in Rule 6710(e) as “an introducing broker, if any, an executing broker-dealer, or a customer.” For purposes of the definition, the term “customer” includes a broker-dealer that is not a FINRA member. See Rule 6710(e).

15. TRACE system hours are currently 8:00:00 a.m. Eastern Time through 6:29:59 p.m. Eastern Time on a business day. See Rule 6710(t).

16. FINRA rules governing trade reporting of equity securities currently require firms to report time to the millisecond if the firm captures time to that level of granularity. See Rule 6380A, Supplementary Material .04; Rule 6380B, Supplementary Material .04; Rule 6622, Supplementary Material .04; see also Regulatory Notice 14-21 (May 2014).

17. FINRA amended Section 1(b)(2) of Schedule A to the FINRA By-Laws to exclude transactions in U.S. Treasury securities from the Trading Activity Fee (TAF) and amended Rule 7730 to exclude transactions in U.S. Treasury securities from the TRACE transaction reporting fees. However, because FINRA will incur costs to expand the TRACE system and to enhance its examination and surveillance efforts to monitor trading activity in U.S. Treasury securities, it is considering the appropriate long-term funding approach for the program and will analyze potential fee structures once it has more data relating to the size and volume of U.S. Treasury security reporting.

18. Although FINRA will register CUSIPs for U.S. Treasury securities in the TRACE system, FINRA expects that if a FINRA member firm engages in a reportable TRACE transaction in a TRACE-eligible security that is not in the TRACE system, the firm will inform FINRA so that the CUSIP can be added.
Executive Summary
FINRA interprets the “as soon as practicable” requirement under FINRA trade reporting rules to require that firms release information relating to over-the-counter (OTC) transactions in NMS stocks to other market participants no sooner than they release such information to a FINRA trade reporting facility for dissemination (or “tape”) purposes.

Questions regarding this Notice may be directed to:
- Dave Chapman, Senior Director, Market Regulation, at (240) 386-4995 or dave.chapman@finra.org; or
- Lisa Horrigan, Associate General Counsel, Office of General Counsel, at (202) 728-8190 or lisa.horrigan@finra.org.

Discussion
Rule 603(a) of SEC Regulation NMS\(^1\) provides that any national securities exchange, national securities association, broker or dealer that distributes information with respect to quotations for or transactions in an NMS stock to a securities information processor, broker, dealer or other persons shall do so on terms that are not unreasonably discriminatory. In adopting Regulation NMS, the Securities and Exchange Commission (SEC or Commission) stated that “adopted Rule 603(a) prohibits [a self-regulatory organization] or broker-dealer from transmitting data to a vendor or user any sooner than it transmits the data to a Network processor.”\(^2\)
In a subsequent order finding violations of Rule 603(a) by a national securities exchange, the SEC stated that:

The Commission has recognized that, due to the consolidation process (i.e., the time from the receipt by the Network Processor of the information from exchanges to the time it distributes consolidated information to the public), information from a Network Processor generally reaches market participants later than information from exchanges' proprietary feeds. See Concept Release, 75 Fed. Reg. at 3601 (citing an average consolidation time of approximately 5-10 milliseconds). Nevertheless, exchanges have an obligation under Rule 603(a) to take reasonable steps to ensure—through system architecture, monitoring, or otherwise—that they release data relating to current best-priced quotations and trades through proprietary feeds no sooner than they release data to the Network Processor, including during periods of heavy trading.

Under FINRA rules, OTC trades in NMS stocks that are executed during the hours that a FINRA trade reporting facility is open must be reported for dissemination purposes as soon as practicable, but no later than 10 seconds, following trade execution. Firms must have policies and procedures reasonably designed to comply with the “as soon as practicable” requirement and must implement systems that commence the trade reporting process without delay upon execution.

Consistent with the SEC staff’s interpretation of Rule 603(a), FINRA interprets the “as soon as practicable” requirement under FINRA rules to also require that firms release information relating to OTC transactions in NMS stocks to other market participants no sooner than they release such information to a FINRA trade reporting facility for dissemination (or “tape”) purposes. Thus, for example, an ATS cannot release trade information to its subscribers (other than the subscriber on whose behalf the trade was executed) before it releases the information to a FINRA trade reporting facility.

FINRA notes that in Regulatory Notice 14-46 (November 2014), FINRA solicited comment on proposed guidance that FINRA interprets the “as soon as practicable” requirement to require that firms not disseminate executed trade information sooner than the trade is reported to FINRA. In response to comments, FINRA modified the language of the guidance to clarify its expectations in this regard. Specifically, the guidance (1) more closely tracks the SEC’s language in the SEC Order, referred to above, by focusing on the release (rather than the dissemination) of trade information, and (2) clarifies for firms that reporting to a FINRA trade reporting facility is the equivalent of reporting to FINRA. Further, FINRA is confirming that firms generally would be considered in compliance with the “as soon as practicable” requirement if they release trade information to a FINRA trade reporting facility and the firm’s subscribers or other market participants contemporaneously, even if the information is received at different times.
Endnotes

1. 17 CFR 242.603(a).


4. The FINRA facilities used for reporting OTC trades in NMS stocks are the Alternative Display Facility (ADF) and two Trade Reporting Facilities (TRFs)—the FINRA/Nasdaq TRF and the FINRA/NYSE TRF.

5. See paragraph (a) and Supplementary Material .02 of Rules 6282, 6380A and 6380B.