

Regulatory Transaction Fee

FINRA Provides Guidance Concerning the Types of Securities Transactions Subject to the Regulatory Transaction Fee

Executive Summary

FINRA is publishing this *Notice* to provide additional guidance on the types of securities transactions that are subject to a regulatory transaction fee under Section 3 of Schedule A to the FINRA By-Laws (Section 3).¹

The regulatory transaction fee generally applies to sales of equity securities that are required to be promptly reported to the OTC Reporting Facility (ORF) (that is, subject to the 90-second reporting requirement), and to sales that are required to be reported to either the Alternative Display Facility (ADF) or a FINRA Trade Reporting Facility (TRF).²

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Background & Discussion

Section 31 of the Securities Exchange Act of 1934 (Act) requires FINRA and the national securities exchanges to pay transaction fees and assessments to the Securities and Exchange Commission (SEC). The fees are designed to recover the costs related to the government's supervision and regulation of the securities markets and securities professionals. Pursuant to Section 31 of the Act (Section 31), FINRA is required to pay fees to the SEC for sales of securities subject to prompt last sale reporting (pursuant to the rules of the SEC or FINRA) or registered on a national securities exchange when those sales are transacted by or through its member firms otherwise than on a national securities exchange. This includes sales transacted by or through a member in securities that are off-exchange trades of exchange-registered securities, sometimes referred to as third market transactions, and to sales of equity securities that are non-exchange-registered securities that are subject to prompt last sale reporting. To recover the

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Notice Type

- Guidance

Suggested Routing

- Compliance
- Finance
- Legal
- Operations
- Senior Management

Key Topic(s)

- Regulatory Transaction Fee
- Section 3 of Schedule A to the FINRA By-Laws
- Section 31 of the Securities Exchange Act of 1934

Referenced Rules & Notices

- FINRA Rule 6110
- FINRA Rule 6220
- FINRA Rule 6281
- FINRA Rule 6282
- FINRA Rule 6310
- FINRA Rules 6380A, 6380B, 6380C
- FINRA Rule 6420
- FINRA Rule 6600 Series
- NTM 96-81
- NTM 02-63
- NTM 04-63
- NTM 05-11
- NTM 06-39
- Regulatory Notice 08-51
- Section 3 of Schedule A to the FINRA By-Laws
- Section 31 of the Securities Exchange Act of 1934

costs of FINRA's Section 31 obligation, FINRA assesses a regulatory transaction fee on firms under Section 3, the amount of which is set in accordance with Section 31.

The transactions that are assessable under Section 3 are reported to FINRA through one of FINRA's trade reporting facilities: the ORF, the ADF, or one of three TRFs.³ FINRA uses the transaction data reported to these automated facilities for billing purposes.⁴ As a general matter, FINRA charges the regulatory transaction fee to the clearing firm on the sell side of a transaction. If no FINRA member firm is on the sell side of a covered transaction (*e.g.*, when a member firm is buying a security from a customer), the regulatory transaction fee is charged to the FINRA member firm on the buy side of the transaction.

The Section 3 regulatory transaction fee applies only to sales transactions effected otherwise than on a national securities exchange. However, not all sales transactions effected otherwise than on a national securities exchange are subject to a regulatory transaction fee. Certain sales transactions are expressly exempt from Section 31 and are, therefore, not subject to a regulatory transaction fee pursuant to Section 3. The following types of sales transactions are exempt from Section 31 and, consequently, from the regulatory transaction fee in Section 3:⁵

- ▶ Sales of a security offered pursuant to an effective registration statement under the Securities Act of 1933 (Securities Act) (except a sale of a put or call option issued by the Options Clearing Corporation) or offered in accordance with an exemption from registration afforded by Section 3(a) or 3(b) of the Securities Act (or a rule thereunder);
- ▶ Sales of a security by an issuer not involving any public offering within the meaning of Section 4(2) of the Securities Act;
- ▶ Sales of a security pursuant to, and in consummation of, a tender or exchange offer;
- ▶ Sales of a security upon the exercise of a warrant or right (except a put or call), or upon the conversion of a convertible security;
- ▶ Sales of a security that are executed outside the United States and are not reported, or required to be reported, to a transaction reporting association as defined in SEC Rule 600 and any approved plan filed thereunder;
- ▶ Sales of an option on a security index (including both a narrow-based security index and a non-narrow-based security index);
- ▶ Sales of a bond, debenture, or other evidence of indebtedness; and
- ▶ Any recognized riskless principal sale.

Accordingly, in general, FINRA is responsible for paying fees for sales transacted by or through its member firms otherwise than on a national securities exchange. The fees apply to equity securities subject to prompt last sale reporting, including sales transacted by or through its member firms in equity securities that are off-exchange trades of exchange-registered securities. This *Notice* explains how FINRA determines which transactions are subject to the regulatory transaction fee in Section 3.

Off-Exchange Trades of Exchange Registered Securities

As noted above, the regulatory transaction fee is applicable to off-exchange trades of exchange-registered securities. Member firms are required to report such trades (*i.e.*, trades in NMS stocks, as defined in SEC Rule 600(b)(47), effected otherwise than on an exchange) within 90 seconds to the ADF or to a TRF.⁶ For purposes of assessing the regulatory transaction fee on trades involving exchange-registered securities, FINRA relies on the primary listing market's classification of the security to determine whether the trade is subject to the regulatory transaction fee. For instance, if the primary listing market considers transactions in a particular security to be subject to Section 31, "FINRA will also assess the regulatory transaction fee on off-exchange trades of that security. FINRA believes that reliance on the primary listing market's classification of an exchange-registered security is necessary to ensure consistent treatment of transactions involving the same security for Section 31 purposes across self-regulatory organizations.

Trades of Non-Exchange Registered Securities

The regulatory transaction fee is also applicable to sales of equity securities that are traded otherwise than on a national securities exchange and are subject to prompt last sale reporting pursuant to the rules of the SEC or FINRA. With a few exceptions, FINRA Rule 6622 requires firms to submit tape reports to the ORF for over-the-counter (OTC) transactions in OTC Equity Securities within 90 seconds of execution. Most OTC trades in OTC Equity Securities are subject to prompt last sale reporting and, accordingly, are subject to the regulatory transaction fee.⁷ In accordance with FINRA Rule 6622, the types of equity securities subject to prompt last sale reporting and, thus, the regulatory transaction fee include: common, preferred, warrants, rights, units, American Depositary Receipts (ADRs) and foreign issues.⁸ This includes many of the securities that are quoted in the OTC market (such as those quoted in the OTC Bulletin Board or the Electronic Pink Sheets). The types of transactions currently excluded from the 90-second reporting requirement include:

- trades in PORTAL securities (as defined in FINRA Rule 6631);⁹
- trades in direct participation program securities (as defined in FINRA Rule 6642);¹⁰ and
- trades in non-exchange-listed convertible bonds, which are subject to the 15-minute trade reporting requirements under the Trade Reporting and Compliance Engine (TRACE) rules.¹¹

Debt Securities

As expressly stated in the Act, sales of bonds, debentures, or other evidence of indebtedness (debt securities) are excluded from Section 31.¹² Because of this exclusion from Section 31, transactions in debt securities are not subject to the regulatory transaction fee under Section 3.

As noted above, for securities that are registered on an exchange, FINRA will defer to the primary listing market to determine whether a particular security is a debt security or an equity security for purposes of assessing the regulatory transaction fee on off-exchange trades of those securities.

To determine whether a non-exchange-registered security is an equity security or a debt security for purposes of assessing the regulatory transaction fee, FINRA relies on the facility to which the transaction is reported. If the transaction must be reported to the ORF, the transaction is treated as one involving an equity security and is subject to the regulatory transaction fee. If the transaction must be reported to TRACE, the transaction is treated as one involving a debt security and thus is not subject to the regulatory transaction fee.

Endnotes

- 1 See *NASD Notice to Members 06-39* (SEC Approves Amendments Relating to Automated Reporting of Transactions Subject to Regulatory Transaction Fee) (August 2006); *NASD Notice to Members 05-11* (NASD Issues Further Guidance Regarding Members' Obligations Under Section 3 of Schedule A to the NASD By-Laws; NASD Also Seeks Member Comment on Related Automation Issues) (February 2005); *NASD Notice to Members 04-63* (New SEC Procedures Relating to Section 31 of the Securities Exchange Act of 1934) (August 2004); see also *NASD Member Alert* (June 27, 2007) (NASD Reiterates Guidance Regarding Member's Disclosure of Regulatory Transaction Fees under Section 3 of Schedule A to the NASD By-Laws).
- 2 Currently, there are three TRFs in operation: the FINRA/NASDAQ TRF, the FINRA/NSX TRF, and the FINRA/NYSE TRF.
- 3 The ORF is used to report transactions in OTC Equity Securities, subject to certain exclusions. See FINRA Rules 6420(d), 6622. The ADF and the TRFs are used to report over-the-counter transactions in NMS stocks, as defined in SEC Rule 600(b)(47). See FINRA Rules 6220(a)(2), 6281, 6310A, 6310B, 6310C. The SEC recently approved the adoption of the NASD Marketplace Rules as FINRA Rules, without substantive change, effective December 15, 2008. See *Regulatory Notice 08-57* (October 2008). Although the NASD Marketplace Rules remain in effect until December 16, 2008, references in this *Notice* are to the new FINRA rules.
- 4 Section 3 requires that transactions subject to the regulatory transaction fee be submitted to FINRA in an automated manner. Transactions reported on Form T are also assessed a regulatory transaction fee.

- 5 See SEC Rule 31(a)(11), 17 CFR 240.31(a)(11). Some of these transactions are not required to be reported to FINRA. For example, among others, transactions that are part of a primary distribution by an issuer and transactions made in reliance on Section 4(2) of the Securities Act of 1933 are expressly excluded from FINRA's trade reporting rules. See FINRA Rules 6282(i), 6380A(e), 6380B(e), 6380C(e), 6622(e).
- 6 See FINRA Rules 6110, 6282, 6380A, 6380B, and 6380C.
- 7 The regulatory transaction fee applies to all transactions in non-exchange registered equity securities that are subject to prompt last sale reporting, regardless of when the transaction occurs. The fee, therefore, applies to transactions in these securities executed outside normal trading hours that would be subject to prompt last sale reporting if the transactions were executed during normal trading hours. See Securities Exchange Act Release No. 38133 (January 7, 1997), 62 FR 1940 (January 14, 1997) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NASD Relating to SEC Transaction Fees) (File No. SR-NASD-96-57).
- 8 Foreign equity securities became subject to prompt last sale reporting on October 27, 2008. See *Regulatory Notice 08-51* (September 2008).
- 9 See FINRA Rule 6633.
- 10 See FINRA Rule 6643.
- 11 Although convertible debt falls within the definition of "equity security" in Section 3(a)(11) of the Act, FINRA has historically treated unlisted convertible debt as debt for purposes of trade reporting and, consequently, has not assessed a regulatory transaction fee on trades in unlisted convertible debt. See Securities Exchange Act Release No. 38133 (January 7, 1997), 62 FR 1940 (January 14, 1997) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NASD Relating to SEC Transaction Fees) (File No. SR-NASD-96-57); see also *Trade Reporting Notice* (February 22, 2008); *Special NASD Notice to Members 96-81* (December 3, 1996). Similarly, FINRA has treated convertible debt as a debt security for purposes of the Trading Activity Fee in Section 1(b) of Schedule A. See *NASD Notice to Members 02-63* (September 2002).
- 12 See 15 U.S.C. 78ee(b), (c); see also SEC Rule 31(a)(11)(vii).

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