

Trade Reporting and Compliance Engine (TRACE)

SEC Approves Amendments Expanding TRACE to Include Agency Debt Securities and Primary Market Transactions

Effective Date: March 1, 2010

Executive Summary

The SEC approved major amendments to the TRACE Rules (FINRA Rule 6700 Series) and FINRA Rule 7730 relating to TRACE fees that will increase the number and type of securities and transactions that will be reported to TRACE. The changes become effective March 1, 2010.

Debt securities that are issued or guaranteed by an Agency or by a Government-Sponsored Enterprise (collectively, Agency Debt Securities) will become TRACE-Eligible Securities, and transactions in such securities will be reported and disseminated. Primary market transactions in TRACE-Eligible Securities will be Reportable TRACE Transactions. For certain primary market transactions—List or Fixed Offering Price Transactions or Takedown Transactions—several significant exceptions to the current TRACE requirements will apply:

- the reporting period for List or Fixed Offering Price Transactions and Takedown Transactions will be extended to the close of business of the day following the day of execution (*i.e.*, to 6:30 p.m. Eastern Time on T+1);
- member firms reporting such transactions will not be required to pay a standard transaction reporting fee; and
- transaction information will not be disseminated.

September 2009

Notice Type

- Rule Amendment
- New Rule

Suggested Routing

- Compliance
- Executive Representatives
- Fixed Income
- Legal
- Operations
- Sales
- Senior Management
- Systems
- Trading
- Training

Key Topic(s)

- Agency Debt Security
- Dissemination
- Emergency Suspension
- Fees
- Government-Sponsored Enterprise
- List or Fixed Offering Price Transaction
- New Issue Notification
- Primary Market Transaction
- Reportable TRACE Transaction
- Takedown Transaction
- TRACE-Eligible Security

Referenced Rules & Notices

- FINRA Rule Series 6700
- FINRA Rule 7730
- NASD Rule 11310(d)

The SEC also approved new FINRA Rule 6770, granting FINRA emergency authority to suspend the reporting and/or dissemination of certain transactions in TRACE-Eligible Securities, or certain reporting or dissemination requirements as market conditions warrant and in consultation with the SEC.

These and other related amendments to the TRACE Rules and FINRA Rule 7730, which the SEC approved on September 28, 2009, are discussed below.¹ The [amended rule text](http://www.finra.org/notices/09-57) is available on our Web site at www.finra.org/notices/09-57.

Questions regarding this *Notice* should be directed to:

- ▶ Elliot R. Levine, Associate Vice President and Counsel, Transparency Services, at (202) 728-8405;
- ▶ Sharon Zackula, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8985; or
- ▶ Patrick Geraghty, Director, Market Regulation, at (240) 386-4973.

Background and Discussion

The SEC approved amendments to the FINRA Rule 6700 Series and FINRA Rule 7730 that will expand transparency in the debt securities markets by adding a significant number of securities—all Agency Debt Securities—to TRACE, and by requiring that all primary market transactions in any TRACE-Eligible Security be reported to TRACE.

The amendments:

1. expand TRACE to include Agency Debt Securities as TRACE-Eligible Securities and restate the definition of TRACE-Eligible Security, including deleting the criteria that a security be Investment Grade or Non-Investment Grade and depository eligible under NASD Rule 11310(d) to be a TRACE-Eligible Security in FINRA Rule 6710(a);
2. in connection with adding Agency Debt Securities to TRACE, incorporate the following new defined terms into FINRA Rule 6710: “Agency,” “Agency Debt Security,” “Asset-Backed Security,” “Government-Sponsored Enterprise” (“GSE”), “Money Market Instrument” and “U.S. Treasury Security”;
3. expand TRACE to include primary market transactions as Reportable TRACE Transactions, as defined in FINRA Rule 6710(c), and in connection therewith, incorporate two additional defined terms, “List or Fixed Offering Price Transaction” and “Takedown Transaction,” in FINRA Rule 6710;
4. require member firms to report transactions in Agency Debt Securities and primary market transactions under FINRA Rule 6730, and incorporate certain modified trade reporting requirements applicable to List or Fixed Offering Price Transactions and Takedown Transactions in FINRA Rule 6730(a)(5) and FINRA Rule 6730(d)(4)(D);

5. provide for the dissemination of information on transactions in Agency Debt Securities and primary market transactions under FINRA Rule 6750, except List or Fixed Offering Price Transactions and Takedown Transactions, as provided in FINRA Rule 6750(b)(3);
6. regarding notification requirements in Rule 6760, establish an alternative notification requirement when a new TRACE-Eligible Security is not assigned a CUSIP; require notification of the time when a new issue is priced and, if different, the time when the first transaction in the distribution or offering is executed; and extend the period for a firm to timely provide all information required in the member firm's notice to FINRA regarding a new TRACE-Eligible Security when the new issue is priced and commences on the same business day between 9:30 a.m. Eastern Time (ET) and 4:00 p.m. ET;
7. grant FINRA emergency authority to suspend the reporting and/or dissemination of certain transactions in TRACE-Eligible Securities, or the reporting of certain data elements otherwise required to be reported and/or the dissemination of certain data elements, as market conditions warrant and in consultation with the SEC in new FINRA Rule 6770; and
8. apply the fee rates currently in effect in FINRA Rule 7730 to transactions in Agency Debt Securities and primary market transactions, and do not require firms to pay a reporting fee when reporting List or Fixed Offering Price Transactions and Takedown Transactions as provided in FINRA Rule 7730(b)(1); distinguish TRACE market data relating to corporate debt from market data relating to Agency Debt Securities (the Agency Data Set); and establish fees for the new Agency Data Set in Rule 7730 generally, including fees that are incorporated in FINRA Rule 7730(a)(1) for "Web Browser Access."²

The most significant changes to the FINRA Rule 6700 Series and FINRA Rule 7730 regarding the expansion of the TRACE program are highlighted below.

Agency Debt Securities

Under the current definition of TRACE-Eligible Security in FINRA Rule 6710(a), among other criteria, a security must be issued by a U.S. or foreign private issuer to be a TRACE-Eligible Security, which makes any security issued by an agency of the U.S. government ineligible.³ In addition, certain types of securities, including a security issued by a GSE, are specifically excluded from the defined term TRACE-Eligible Security.⁴

The amendments expand the term TRACE-Eligible Security to include a debt security that is issued or guaranteed by an Agency or a GSE. For purposes of FINRA Rule 6710(k), "Agency" will be defined by incorporating a broad statutory term, "executive agency," from 5 U.S.C. 105. Although the U.S. Department of the Treasury is defined as an executive agency under this federal statutory provision, for purposes of TRACE, the term "Agency" will not include the U.S. Treasury in the exercise of its authority to issue U.S. Treasury Securities.⁵

GSEs were created at different times and for different purposes, do not present uniform structures and, prior to and after the market events in 2008, have not been treated uniformly under various federal regulatory schemes. In FINRA Rule 6710(n), FINRA has defined an issuer or guarantor that is a GSE for purposes of TRACE by reference to the statutory definition in 2 U.S.C. 622(8).⁶ Fannie Mae and Freddie Mac are examples of issuers or guarantors that are GSEs.⁷

Under new FINRA Rule 6710(l), the securities of both types of issuers (or guarantors of issues) will be defined collectively as “Agency Debt Securities,” which reflects industry convention. Specifically, under FINRA Rule 6710(l) “Agency Debt Security” will be defined as a debt security (i) issued or guaranteed by an Agency as defined in paragraph (k); or (ii) issued or guaranteed by a GSE as defined in paragraph (n). The definition also explicitly excludes U.S. Treasury Securities.

Several of the institutions that are defined as Agencies or GSEs, such as Ginnie Mae,⁸ Freddie Mac and Fannie Mae, are well-known issuers or guarantors of mortgage-backed and other structured securities. However, for purposes of TRACE, such securities, which are Asset-Backed Securities as broadly defined in FINRA Rule 6710(m), will not be included in the definition of TRACE-Eligible Security, as amended.⁹

With the foregoing parameters included, a TRACE-Eligible Security will be defined in amended FINRA Rule 6710(a) as:

a debt security that is United States dollar-denominated and 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; or is a debt security that is U.S. dollar-denominated and issued or guaranteed by an Agency as defined in paragraph (k) or a Government-Sponsored Enterprise as defined in paragraph (n). “TRACE-Eligible Security” does not include a debt security that is:

- (1) issued by a foreign sovereign or is a U.S. Treasury Security as defined in paragraph (p);
- (2) a Money Market Instrument as defined in paragraph (o); or
- (3) an Asset-Backed Security as defined in paragraph (m).

Primary Market Transactions

FINRA Rule 6710(c) currently defines “Reportable TRACE Transaction” as any secondary market transaction in a TRACE-Eligible Security except transactions that are not reported as specified in FINRA Rule 6730(e). As amended, FINRA Rule 6710(c) is not limited to secondary market transactions, and firms will be required to report primary market transactions in any TRACE-Eligible Security.

FINRA has identified two types of primary market transactions, List or Fixed Offering Price Transactions and Takedown Transactions, that will be subject to more liberal trade reporting requirements and two other significant modifications to the current TRACE requirements due to the nature of the transactions and the assumption that such transactions (in a single security) will be executed at a single price. A List or Fixed Offering Price Transaction will be defined in FINRA Rule 6710(q) as:

a primary market sale transaction sold on the first day of trading of a new issue: (i) by a sole underwriter, syndicate manager, syndicate member or selling group member at the published or stated list or fixed offering price, or (ii) in the case of a primary market sale transaction effected pursuant to Securities Act Rule 144A, by an initial purchaser, syndicate manager, syndicate member or selling group member at the published or stated fixed offering price.

A Takedown Transaction will be defined similarly in Rule 6710(r).¹⁰

The current TRACE requirements that will be modified for List or Fixed Offering Price Transactions and Takedown Transactions are:

- List or Fixed Offering Price Transactions and Takedown Transactions will not be subject to 15-minute reporting. Instead, member firms will be permitted to report a List or Fixed Offering Price Transaction or a Takedown Transaction that is executed on a business day at or after 12:00 a.m. ET through 11:59:59 p.m. ET, not later than T+1 during TRACE system hours under Rule 6730(a)(5).¹¹
- List or Fixed Offering Price Transactions and Takedown Transactions will not be disseminated as provided in FINRA Rule 6750(b)(3).
- A member firm that reports timely a List or Fixed Offering Price Transaction or a Takedown Transaction will not be required to pay the standard transaction reporting fee set forth in FINRA Rule 7730(b)(1). However, firms that report such transactions incorrectly or late will incur “Cancel/correct” and “As/of Trade Late” fees.

Emergency Authority

Under new Rule 6770, FINRA will possess emergency authority regarding TRACE. FINRA may suspend the reporting and/or dissemination of certain transactions in TRACE-Eligible Securities, or the reporting of certain data elements that are otherwise required to be reported under FINRA Rule 6730, and/or the dissemination of certain data elements, as market conditions warrant and in consultation with the SEC.

Conclusion

Effective March 1, 2010, firms must begin reporting transactions in Agency Debt Securities and primary market transactions and otherwise comply with all other requirements in the TRACE Rules, as amended, and amended FINRA Rule 7730.

Endnotes

- 1 See Exchange Act Release No. 60726 (September 28, 2009), 74 FR 50991 (October 2, 2009) (Order Approving Proposed Rule Change; File No. SR-FINRA- 2009-010).
- 2 Other changes that will be incorporated in the TRACE Rules and FINRA Rule 7730 include amendments to: 1) FINRA Rule 6710(h) to state that FINRA will classify an unrated Agency Debt Security as an Investment Grade security for purposes of the dissemination of transaction volume; and 2) the FINRA Rule 6700 Series and FINRA Rule 7730 to incorporate minor amendments that conform or clarify rule text or eliminate unnecessary provisions.
- 3 In addition, FINRA Rule 6710(a) requires that a security that is a TRACE-Eligible Security be U.S. dollar denominated; depository eligible under NASD Rule 11310(d); Investment Grade or Non-Investment Grade (as defined, respectively, in FINRA Rules 6710(h) and (i)); and, if a “restricted security” as defined in Securities Act Rule 144(a)(3), sold pursuant to Securities Act Rule 144A.
- 4 Other securities that are excluded are mortgage- or asset-backed securities, collateralized mortgage obligations, and money market instruments (having at issuance a maturity of one year or less).
- 5 Specifically, “Agency” will be defined in FINRA Rule 6710(k) as:
 - a U.S. “executive agency” as defined in 5 U.S.C. 105 that is authorized to issue debt directly or through a related entity, such as a government corporation, or to guarantee the repayment of principal and/or interest of a debt security issued by another entity. The term excludes the U.S. Department of the Treasury (Treasury) in the exercise of its authority to issue U.S. Treasury Securities as defined in paragraph (p).

5 U.S.C. 105 defines “executive agency” broadly to include “an Executive department, a Government corporation, and an independent establishment.” Debt securities issued by most government agencies or government-affiliated entities will be included under this definition. “Executive department” is defined in 5 U.S.C. 101 to include cabinet-level agencies or departments (*e.g.*, the Department of State, the Department of the Treasury, the Department of Commerce, the Department of Homeland Security, etc.). “Government Corporation” is defined in 5 U.S.C. 103 as “a corporation owned or controlled by the Government of the United States....” (*e.g.*, the Pension Benefit Guaranty Corporation is a wholly owned government corporation). “Independent establishment” is defined in 5 U.S.C. 104 as “(1) an establishment in the executive branch (other than the United States Postal Service or the Postal Regulatory Commission) which is not an Executive department, military department, Government corporation, or part thereof, or part of an independent establishment; and (2) the General Accounting Office.” (For example, the Federal Reserve Banks are independent establishments.)

Endnotes Continued

- 6 In FINRA Rule 6710(l), the definition of Agency Debt Security will provide, in pertinent part, that the term Agency Debt Security excludes “an Asset-Backed Security as defined in paragraph (m) where an Agency or a Government-Sponsored Enterprise is the sponsor of the trust or other entity that issues the Asset-Backed Security, or is the guarantor of the Asset-Backed Security.”
- 7 Fannie Mae is the Federal National Mortgage Association. Freddie Mac is the Federal Home Loan Mortgage Corporation.
- 8 Ginnie Mae is the Government National Mortgage Association.
- 9 In FINRA Rule 6710(m) “Asset-Backed Security” will mean:
an asset-backed security as used in Securities Act Regulation AB, Section 1101(c), a mortgage-backed security, a collateralized mortgage obligation, a synthetic asset-backed security, or any instrument involving or based on the securitization of mortgages or other credits or assets, including but not limited to a collateralized debt obligation, a collateralized bond obligation, a collateralized debt obligation of asset-backed securities or a collateralized debt obligation of collateralized debt obligations.
- 10 Specifically, a Takedown Transaction will be defined in FINRA Rule 6710(r) as:
a primary market sale transaction sold on the first day of trading of a new issue: (i) by a sole underwriter or syndicate manager to a syndicate or selling group member at a discount from the published or stated list or fixed offering price, or (ii) in the case of a primary market sale transaction effected pursuant to Securities Act Rule 144A, by an initial purchaser or syndicate manager to a syndicate or selling group member at a discount from the published or stated fixed offering price.
- 11 Like FINRA Rule 6730(a)(4), FINRA Rule 6730(a)(5) will include extended reporting periods for transactions that occur on a Saturday, a Sunday, or a federal or religious holiday when the TRACE system is closed.
Under FINRA Rule 6730(d)(4)(D), members will be required to append the new indicator that identifies List or Fixed Offering Price Transactions and Takedown Transactions when reporting such transactions.