Regulatory Notice 11-40

Trade Reporting

SEC Approves Amendments Clarifying Certain Exceptions Under Trade Reporting Rules and Adopting Notice Requirement for Transactions That Are Part of an Unregistered Secondary Distribution

Effective Date: November 1, 2011

Executive Summary

The SEC approved amendments to FINRA rules clarifying that, for purposes of the exception from the trade reporting requirements for transactions that are part of a distribution of securities, "distribution" has the meaning set forth under SEC Regulation M. Effective November 1, 2011, firms that rely on the exception for transactions that are part of an "unregistered secondary distribution" must provide FINRA notice and information relating to the transactions, as described herein.

The SEC also approved amendments clarifying that transfers of securities for the purpose of creating or redeeming instruments such as American Depositary Receipts and exchange-traded funds are expressly excluded from the trade reporting requirements.

The text of the amendments can be found at *www.finra.org/rulefilings/2011-027*.

Questions regarding this *Notice* may be directed to:

- Legal Section, Market Regulation, at (240) 386-5126; or
- Office of General Counsel at (202) 728-8071.

Financial Industry Regulatory Authority

August 2011

Type of Notice

- Rule Amendment

Suggested Routing

- Compliance
- Executive Representatives
- Legal
- Operations
- Senior Management
- Systems
- Trading
- Training

Key Topics

- Alternative Display Facility
- American Depositary Receipts
- Distributions
- Exchange-Traded Funds
- NMS Stocks
- OTC Equity Securities
- OTC Reporting Facility
- Trade Reporting
- Trade Reporting Facilities

Referenced Rules & Notices

- FINRA Rule 5190
- FINRA Rule 6282
- FINRA Rule 6380A
- FINRA Rule 6380B
- FINRA Rule 6622
- NTM 07-25
- Schedule A to the FINRA By-Laws
- SEC Regulation M

Background and Discussion

Under FINRA trade reporting rules, firms are required to report OTC equity transactions[1] to FINRA unless they fall within an express exception. As a general matter, when firms report OTC trades, FINRA facilitates the public dissemination of the trade information and/or assesses regulatory transaction fees under Section 3 of Schedule A to the FINRA By-Laws (Section 3)[2] and the Trading Activity Fee (TAF).[3]

Certain transactions and transfers are not reported to FINRA at all (*e.g.*, trades executed and reported through an exchange and transfers made pursuant to an asset purchase agreement that has been approved by a bankruptcy court), while other transactions must be reported to FINRA for regulatory transaction fee assessment purposes only (*e.g.*, away from the market sales and transfers in connection with certain corporate control transactions).[4] Firms must have policies and procedures and internal controls in place, including, as necessary, consultation with their counsel, to determine whether a transaction qualifies for an exception under the rules.

On August 3, 2011, the SEC approved a rule change relating to certain exceptions to the trade reporting requirements.[5] As described more fully below, the amendments:

1) clarify the exception for transactions that are part of a distribution of securities and impose a new notice requirement relating to unregistered secondary distributions, and
2) expressly exclude transfers of equity securities for the purpose of creating or redeeming instruments such as American Depositary Receipts (ADRs) and exchange-traded funds (ETFs).

Transactions that are part of a securities distribution

FINRA rules contain an exception from the trade reporting requirements for transactions that are effected in connection with a distribution of securities, specifically:

> transactions that are part of a primary distribution by an issuer or of a registered secondary distribution (other than "shelf distributions") or of an unregistered secondary distribution.[6]

Thus, transactions that are part of a distribution (other than a secondary shelf distribution) are not reported to FINRA or publicly disseminated, and they are not assessed regulatory transaction fees under Section 3 or the TAF.

The amendments clarify that for purposes of this trade reporting exception, "distribution" has the meaning set forth under SEC Regulation M.[7] A "distribution" is defined under Rule 100 of Regulation M as "an offering of securities, whether or not subject to registration under the Securities Act, that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods."[8]

Firms are reminded that under FINRA rules, large block trades (even those at a significant discount from the current market price) must be reported to FINRA for tape dissemination purposes and are assessed regulatory transaction fees under Section 3 and the TAF. The amendments clarify that the trade reporting exception does not apply to block trades, unless they otherwise meet the definition of "distribution" under Regulation M.

Notice requirement for transactions that are part of an "unregistered secondary distribution"

Pursuant to new Supplementary Material in Rules 6282, 6380A, 6380B and 6622, firms that would otherwise have the trade reporting obligation under FINRA rules[9] must provide notice to FINRA that they are relying on the exception for transactions that are part of an "unregistered secondary distribution." The firm also must provide the following information to FINRA for each transaction that is part of the unregistered secondary distribution and not reported:

- security name and symbol;
- execution date;
- execution time;
- number of shares;
- trade price; and
- FINRA member firms that are parties to the trade.[10]

Firms are required to provide such notice and information no later than three business days following trade date. If the trade executions will occur over multiple days, then initial notice and available information must be provided no later than three business days following the first trade date and final notice and information must be provided no later than three business days following the last trade date.

Such notice and information should be provided on the Regulation M Trading Notification Form. An updated version of the form is available as an attachment to this Notice, and will be available as of November 1, 2011, at *www.finra.org/RegM*, and should be submitted to FINRA's Market Regulation Department via:

- email to *secondaryofferings@finra.org*;
- fax to (301) 339-7403; or
- a third-party vendor (*e.g.*, Dealogic, Ipreo).[11]

Firms also may obtain a version of the Regulation M Trading Notification Form that can be completed and submitted electronically by emailing a request to FINRA.

FINRA is combining the form of notice required under the trade reporting rules with the form of notice required under Rule 5190[12] to streamline firms' reporting obligations since, if a firm is relying on this trade reporting exception, applicable notice requirements under Rule 5190 also must be satisfied. However, firms are reminded that the notice requirement under the trade reporting rules is separate and distinct from the notice requirements under Rule 5190. Accordingly, providing notice under the trade reporting rules does not relieve a firm of any additional notification obligations it may have under Rule 5190 (and vice versa), nor does it impact the timing of any notice required under Rule 5190. Firms must comply with the requirement under Rule 5190 to submit the Regulation M Trading Notification Form no later than the close of business the next business day following pricing of the distribution, irrespective of the fact that firms have until three days after trade date to provide notice and information under the trade reporting rules.[13]

The new Supplementary Material also requires that the firm retain records sufficient to document the basis for relying on this trade reporting exception, including, but not limited to, the basis for determining that the transactions are part of a distribution, as defined under Regulation M. Firms must be able to demonstrate that the "magnitude of the offering" and "special selling efforts" criteria under Regulation M have been satisfied. The mere assertion that the order was large sized or a block or that execution of the order was "worked" by a firm will not by itself be sufficient.

Transfers of equity securities to create or redeem instruments such as ADRs and ETFs

The amendments expressly exclude from the trade reporting requirements any transfer of equity securities for the sole purpose of creating or redeeming an instrument, such as an ADR or ETF, that evidences ownership of or otherwise tracks the underlying securities transferred. Such transfers are not considered OTC transactions for purposes of the trade reporting rules and thus are not reportable events.

The amendments codify current guidance and practice in this area. For example, FINRA has previously stated that the conversion of foreign ordinary shares into ADRs (or vice versa) at a bank depository is not a trade reportable event.[14] Similarly, when a financial institution or "authorized participant" deposits with an ETF a basket of securities (or other assets) and receives the ETF creation unit in return, these are not trade reportable events.

FINRA notes that the exception applies irrespective of whether a firm is acting as agent, principal or riskless principal in the creation process. For example, an authorized participant, as riskless principal on behalf of a customer, transfers securities to an ETF and in return receives ETF creation units. The transfer of the shares and receipt of ETF creation units by the authorized participant are not reportable events. Similarly, the subsequent "flip" of the ETF creation units from the authorized participant to its customer also is not reportable.

Firms are reminded, however, that purchases and sales of the securities that are to be transferred for the purpose of creating or redeeming instruments such as ADRs and ETFs, and subsequent purchases and sales of the instruments themselves in the secondary market, are OTC transactions and must be reported to FINRA in accordance with the trade reporting rules.[15] Additionally, purchases and sales of the underlying securities in order to track the performance of an instrument such as an ADR or ETF, without actually creating the instrument, must be reported.

Endnotes

1. Specifically, OTC equity transactions are transactions effected otherwise than on an exchange in: (1) NMS stocks, as defined in SEC Rule 600(b) of Regulation NMS, which are reported through the Alternative Display Facility (ADF) or a Trade Reporting Facility (TRF); and (2) OTC equity securities, as defined in FINRA Rule 6420 (i.e., non-NMS stocks), which are reported through the OTC Reporting Facility (ORF).

2. Pursuant to Section 31 of the Act, FINRA and the national securities exchanges are required to pay transaction fees and assessments to the SEC that are designed to recover the costs related to the government's supervision and regulation of the securities markets and securities professionals. FINRA obtains its Section 31 fees and assessments from its membership in accordance with Section 3.

3. The TAF is one of the member regulatory fees FINRA uses to fund its member regulation activities, market regulation activities, financial monitoring and policymaking, rulemaking and enforcement activities. Among others, the TAF is assessed for the sale of all exchange registered securities wherever executed and OTC equity securities. *See* FINRA By-Laws, Schedule A, § 1(b)(2).

4. *See* Rules 6282(i), 6380A(e), 6380B(e) and 6622(e).

5. *See* Securities Exchange Act Release No. 65025 (August 3, 2011), 76 FR 48937 (August 9, 2011) (Order Approving SR-FINRA-2011-027).

6. *See* Rules 6282(i)(1)(A), 6380A(e)(1)(A), 6380B(e)(1)(A) and 6622(e)(1)(A).

7. 17 CFR 242.100–105.

8. 17 CFR 242.100.

9. In transactions between member firms, the "executing party," as defined by rule, is required to report the trade. In transactions between a member firm and a non-member firm or customer, the member firm is required to report. *See* Rules 6282(b), 6380A(b), 6380B(b) and 6622(b).

10. Firms must identify FINRA member firms that are the contra parties to the trade; they are not required to identify customers.

11. FINRA notes that this is a notice requirement only—and not a trade reporting requirement. Accordingly, these transactions are not reported to a FINRA trade reporting facility (*i.e.*, the ADF, a TRF or the ORF), nor is any of the information disseminated to the public. In addition, these transactions are not assessed regulatory transaction fees under Section 3 or the TAF.

    FINRA further notes that firms are required to submit notice and information under the trade reporting rules only to FINRA. A firm would not be required to submit such information as part of any Regulation M-related submission pursuant to the rules of another self-regulatory organization.

12. Rule 5190 imposes certain notice requirements on member firms participating in distributions of listed and unlisted securities and is designed to ensure that FINRA receives pertinent distribution-related information from firms in a timely fashion to facilitate its Regulation M compliance program.

13. In other words, firms cannot delay submission of the Regulation M Trading Notification Form in order to provide trade information, as required under the trade reporting rules, and argue that "such later notification is necessary under specific circumstances," as provided for under Rule 5190.

14. See *NTM 07-25* (May 2007).

15. For example, firms are required by rule to include the date and time of execution in all trade reports submitted to FINRA; the date and time of execution are the date and time when the parties have agreed to all essential terms of the transaction, including trade price and number of shares.

Regulation M—Trading Notification Form

Attention: FINRA Market Regulation Department; FINRA ADF Operations; NASDAQ MarketWatch Department

Please provide the following information

Original notification: ☐ yes ☐ no

Does the original notification include unregistered secondary distribution transaction reports? ☐ yes ☐ no

Amended notification: ☐ yes ☐ no

Does the amended notification include unregistered secondary distribution transaction reports? ☐ yes ☐ no

1. Issuer name and symbol: ______________________________

2. Symbol(s) of covered securities
(subject and reference securities, as defined under SEC Regulation M Rule 100): ______________________________

Pursuant to FINRA Rule 5190(c)(1)(B), FINRA Rule 5190(d)(2), FINRA Rule 6275(f)(2), and/or NASDAQ Rule 4619(e)(5), the following information regarding the pricing of a distribution of securities is provided. Additionally, for the distribution participants and/or affiliated purchasers identified below, to the extent that they are market makers, rescission of excused withdrawal status or passive market making status is requested:

3. Type of security offered: ______________________________

4. Number of shares offered: ______________________________

5. Offering price: ______________________________

6. Last sale before distribution: ______________________________

7. Pricing basis: ______________________________
(*e.g.*, last sale, discount to last sale, negotiated, at the market, etc.)

8. Pricing date: ______________________________

9. SEC effective date and time: ______________ (date) ______________ (time)

10. Trade date: ______________________________

11. Restricted period: ☐ 1 day ☐ 5 day ☐ not applicable : ______________ (commencement date)
______________ (end date)

12. Distribution participants and/or affiliated purchasers:

Member Firm	**MPID(s)**
1. ______________	______________
2. ______________	______________
3. ______________	______________
4. ______________	______________
5. ______________	______________
6. ______________	______________
7. ______________	______________
8. ______________	______________

Pursuant to FINRA Rule 5190(d)(1), the following information regarding the basis for determining the applicability of the "actively traded" securities exception under SEC Regulation M Rule 101 is provided:

☐ UAR (for a security listed on the NASDAQ Stock Exchange). Date of UAR: ______________

☐ The following:

1. The ADTV, as defined under SEC Regulation M Rule 100: ______________
   The source of this information: ______________
2. The public float value, as defined under SEC Regulation M Rule 100: ______________
   The source of this information: ______________

☐ Other: ______________________________

Pursuant to FINRA Rule 5190(e)(2), NASDAQ Rule 4614(d)(1) and/or NASDAQ Rule 4624(c), the following information regarding the specified activity, on the date shown, is provided:

Activity	**Date(s) of Activity**	**Aggregate # of Shares**
☐ Engaged in a syndicate covering transaction:	____________________	____________________
☐ Imposition of penalty bid:	____________________	____________________
☐ Stabilizing bid:	____________________	____________________

Pursuant to FINRA Rules 6282, 6380A, 6380B and 6622, the following information relating to transactions that are part of an unregistered secondary distribution and that have not been trade reported, is provided:

Security Name	Symbol	Execution Date	Execution Time	Number of Shares	Execution Price	Buying Member Firm	Selling Member Firm

Submitted by

Firm name: ______________________________

Date: ______________________________

Signature: ____________________ Print name: ____________________

Title: ______________________________

Contact (if different from above): ______________________________

Telephone number: ____________________ Fax number: ____________________

Email address: ______________________________

Pursuant to the requirements of the aforementioned rules, completed forms may be faxed to FINRA Market Regulation at (301) 339-7403, FINRA ADF Operations at (240) 386-6225 and NASDAQ MarketWatch at (301) 978-8511. For other submission methods, see www.finra.org/RegM.