

Financial Industry Regulatory Authority

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August 26, 2009

Elizabeth M. Murphy Secretary U.S. Securities and Exchange Commission 100 F Street, N.E. Washington, DC 20549-1090

Re: File No. SR-FINRA-2009-010 - Response to Comments

Dear Ms. Murphy:

This letter responds to comments submitted to the Securities and Exchange Commission ("SEC") regarding the above-referenced rule filing, a proposed rule change to amend the Rule 6700 Series to require the reporting of transactions in Agency Debt Securities, as defined in proposed Rule 6710(1), and primary market transactions, and the dissemination of transactions in Agency Debt Securities and certain primary market transactions. FINRA also proposes to amend FINRA Rule 7730 regarding reporting and market data fees for transactions in Agency Debt Securities and primary market transactions. On April 8, 2009, FINRA filed Partial Amendment No. 1 to SR-FINRA-2009-010 to make certain technical changes. The SEC published the proposed rule change for notice and comment on April 8, 2009. The comment period closed on May 7, 2009, and eight comment letters were filed. 2

See Securities Exchange Act Release No. 59733 (April 8, 2009), 74 FR 17709 (April 16, 2009) (Notice of Filing and Request for Comment for File No. SR-FINRA-2009-010).

See letters to Elizabeth M. Murphy, Secretary, SEC, from: Beth N. Lowson, The Nelson Law Firm, dated May 5, 2009 ("Lowson Letter"); Heather Traeger, Associate Counsel, Investment Company Institute ("ICI"), dated May 7, 2009 ("ICI Letter"); Sean C. Davey, Managing Director, and Robert Toomey, Managing Director and Associate General Counsel, Capital Markets Group, Securities Industry and Financial Markets Association ("SIFMA"), dated May 7, 2009 ("SIFMA Letter"); Joseph W. Sack, Managing Director, Asset Management Group, SIFMA, dated May 7, 2009 ("SIFMA-AMG Letter"); Michael Decker and Mike Nicholas, Co-Chief Executive Directors, Regional Bond Dealers Association ("RBDA"), dated May 7, 2009 ("RBDA Letter"); and Don Winton, Crews & Associates, Inc., dated May 22, 2009 ("Crews Letter"); letter to Florence E. Harman, Deputy Secretary, SEC, from Manisha Kimmel, Executive

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Of the eight commenters, four commenters expressed general support regarding increased transparency in the debt markets and the expansion of TRACE to include Agency Debt Securities and primary market transactions.³ Two other commenters indicated their support for more transparency in fixed income markets, but opposed the proposed rule change in full.⁴ In addition, they raised operational issues.⁵ The final two commenters were not opposed to the entire proposal, but raised operational concerns and issues.⁶

Three of four commenters favoring FINRA initiatives to foster additional transparency in the bond markets favored the proposal as a whole. One of the three commenters favored the proposal without limitation, stating that TRACE brings significant benefits to investors in bonds, including funds and their shareholders, and that transparency helps to improve price discovery and ensure the integrity of the debt markets. In addition, the commenter noted that accurate trade reporting is critical and requiring accuracy maintains the reliability of disseminated bond pricing over time. The second of the three commenters strongly supported the proposal because it provides for increased price transparency in the market, but requested that the SEC require FINRA to modify its current dissemination protocols, which limit the display of volume (or size, using par value) in many trades in disseminated TRACE data. The commenter requested that the SEC require FINRA to eliminate the dissemination protocols and disseminate, in all disseminated trades, the actual volume of bonds traded. Since dissemination protocols are not the subject matter of the proposed rule change and comment was not solicited

Director, Financial Information Forum ("FIF"), dated May 7, 2009 ("FIF Letter"); and letter to the SEC, from Robert F. Anderson, CFA, Senior Managing Director, Fixed Income Trading ("FIT"), dated April 17, 2009 ("FIT Letter").

- See Lowson Letter, ICI Letter, SIFMA-AMG Letter, and FIT Letter.
- ⁴ <u>See SIFMA Letter and RBDA Letter.</u>
- See SIFMA Letter and RBDA Letter.
- See Crews Letter and FIF Letter.
- See Lowson Letter, ICI Letter and SIFMA-AMG Letter.
- 8 See ICI Letter.
- See Lowson Letter. The FINRA dissemination protocols limit the display of volume (or size) (measured in par value) to \$5 million plus, when the transaction volume for an Investment Grade security exceeds \$5 million (par value) and \$1 million plus, when the transaction volume for a Non-Investment Grade security exceeds \$1 million (par value), instead of displaying the *actual* size of such transactions.

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regarding this issue, FINRA believes that response to this and other comments that are beyond the scope of the proposed rule change is neither appropriate nor necessary. The third of the three commenters supported the current FINRA proposal, noting that its buy-side members were in favor of obtaining actual prices in Agency Debt Securities in near real-time, which would be used to obtain better prices and to enhance portfolio management and valuation activities. A fourth commenter supported FINRA's overall objective to improve bond market transparency, but stated that FINRA has failed to address the most pressing problem in the debt market, which is the lack of transparency in mortgage-backed securities and asset-backed securities. Again, FNRA declines to respond to comments beyond the scope of the proposed rule change.

Opposition to the Proposal Generally. The two commenters that oppose the proposed rule change stated that the Agency Debt Securities market sector is generally liquid and competitive. ¹² The commenters oppose transparency based on an assertion that TRACE may impair liquidity. FINRA does not consider this assertion to be supported by evidence or any parallel development in the securities in the corporate bond market reported to TRACE.

The two commenters also state that the Agency Debt Securities market is already transparent. While FINRA also recognizes that there are multiple vendors that provide data on Agency Debt Securities to their subscribers, there is no centralized public dissemination of information regarding transactions in Agency Debt Securities. Moreover, currently to the extent that professional market participants have access to information, it is pre-trade information comprised of quotes and indications of interest. In most cases, this information is indicative and not necessarily the price at which the investor can or will transact. Post-trade transparency, whether via a subscriber service or at a publicly accessible web site, is generally not available. The expansion of TRACE will create consolidated post-trade transparency in Agency Debt Securities, and the dissemination of transaction information will assist in price discovery and valuation processes for all market participants and provide retail investors access to price information currently not readily available to non-professionals. The information will be accessible to firms, and other institutional market participants and the public generally.

Covered Securities. A commenter requested that FINRA provide a list of the issuers of the "Agency Debt Securities" that would be subject to the requirements of the Rule 6700

See SIFMA-AMG Letter. Other issues unrelated to the proposed rule change were raised, but are not relevant to the proposed rule change for which comment was solicited.

See FIT Letter.

See SIFMA Letter and RBDA Letter.

^{13 &}lt;u>See SIFMA Letter and RBDA Letter.</u>

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Series under the proposed rule change. The commenter also requested that FINRA define the covered securities by reference to "Government securities" as defined in Exchange Act Section 3(a)(42) or certain "exempted securities" as set forth in Securities Act Section 3(a)(2). Over time, the list of issuers of Agency Debt Securities may change, and FINRA declines to incorporate a list of issuers that may issue securities that would be subject to the Rule 6700 Series. In connection with the proposed definitions of "Agency," "Government-Sponsored Enterprise (GSE)," and "Agency Debt Securities," FINRA believes that the proposed definitions of such terms most accurately, clearly and succinctly delineate the group of securities that FINRA intends to add to the universe of TRACE-Eligible Securities in the proposed rule change and, consequently, declines to make the proposed amendments. ¹⁵

Primary Market Transaction Reporting. Some commenters requested greater clarity regarding the distinction between primary and secondary transactions for TRACE reporting purposes. In response to the concerns raised by the commenters, FINRA will propose an amendment to Rule 6730(d)(4)(D) to eliminate the proposed indicators for secondary market transactions and for primary market transactions that are not List or Fixed Offering Price Transactions or Takedown Transactions. Rule 6730(d)(4)(D) would retain the requirement that members use the remaining proposed indicator when reporting primary market transactions that are List or Fixed Offering Price Transactions and Takedown Transactions.

As proposed, FINRA's definitions of a List or Fixed Offering Price Transaction and a Takedown Transaction include the requirement that such transactions occur on the day that the offering is priced. In addition, in its original filing, FINRA proposed to delay the reporting of List or Fixed Offering Price Transactions and Takedown Transactions to the end of the day of pricing. However, if such an offering was priced after 5:00 p.m. Eastern Time, a member was permitted to report transactions executed that day on the trade date or T+1 during the TRACE system hours. A commenter suggested that FINRA amend the definitions of List or Fixed Offering Price Transaction and Takedown Transaction to include primary market transactions that are executed after the day of pricing but otherwise would qualify. FINRA does not believe that the proposed

See SIFMA Letter.

For example, the term "government securities" as defined in Exchange Act Section 3(a)(42) is overly broad, and Securities Act Section 3(a)(2) refers to certain "exempted securities" that are already defined as TRACE-Eligible Securities as of June 15, 2009. (See Securities Exchange Act Release No. 59768 (April 14, 2009), 74 FR 18271) (April 21, 2009) (Order Approving File No. SR-FINRA-2009-004).

See SIFMA Letter, RDBA Letter and FIF Letter.

See SIFMA Letter.

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definitions of List or Fixed Offering Price Transactions and Takedown Transactions should be amended. However, in response to the concerns raised by the commenter, in proposed Rule 6730(a)(5), FINRA proposes to amend the deadline for reporting all List or Fixed Offering Price Transactions and Takedown Transactions to not later than T+1 during TRACE system hours. By extending the reporting period for List or Fixed Offering Price Transaction and Takedown Transaction to T+1, FINRA eliminates the distinction between a transaction executed in connection with an offering that is priced before 5:00 p.m. Eastern Time and a transaction executed as part of an offering priced on the same day but after 5:00 p.m. Eastern Time when the TRACE system is closed. FINRA believes this change will address the operational concerns raised without negatively impacting regulatory surveillance or market transparency, as these transactions are not subject to dissemination.

Rule 6760 Notice Requirements. Rule 6760 generally requires an underwriter (or another person designated under the Rule) to notify FINRA Operations of any new TRACE-Eligible Security that is about to be priced and sold in a primary offering or distribution or any type of initial sale. One commenter requested that FINRA provide more flexible notice requirements in Rule 6760 in the case of certain offerings referred to as "reverse inquiries. The commenter noted that in a "reverse inquiry" the new issue materializes and the primary market transaction takes place precisely upon the agreement of the issuer to sell bonds at the terms proposed by the investor. The commenter suggested modifying Rule 6760 to allow a member to notify FINRA Operations of such new issue TRACE-Eligible Securities not later than 15 minutes after the commencement of primary market trading. FINRA recognizes that the timing and process of certain intraday offerings, such as at-the market shelf "takedowns," "bought deals" and "reverse inquires" are different from fixed price syndicate offerings, and in response to the concerns raised by the commenter, FINRA proposes to amend Rule 6760 regarding member obligations to provide notification in certain circumstances. If a member is involved in an intraday offering that is priced and commences between 9:30 a.m. Eastern Time and 4:00 p.m. Eastern Time, the proposed amendment would require the person to provide to FINRA Operations as much of the information required under Rule 6760 that is available prior to the execution of the first transaction in the distribution or offering, and all other information required under the Rule within 15 minutes of the Time of Execution of the first transaction in such distribution or offering.

Operations and Implementation Issues. The two commenters that opposed the proposal and two other commenters raised one or more operational concerns and implementation issues, including but not limited to modifications of trade reports (i.e., "cancels and corrects"), the TRACE Issue Master as a comprehensive source for all TRACE-Eligible Securities, securities not assigned CUSIPs, and the proposed period for implementation of the rule change following SEC approval. ¹⁹

See RBDA Letter.

See SIFMA Letter, RBDA Letter, Crews Letter and FIF Letter.

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The comments regarding the modification of trade reports are not relevant to the proposed rule change. Notwithstanding, FINRA notes that FINRA reviews operational issues raised by firms on an ongoing basis and will take the issues raised under consideration.

Some commenters stated that firms should be permitted to rely on the TRACE Issue Master to determine if a security is a TRACE-Eligible Security. While FINRA agrees that the TRACE Issue Master is an important tool, FINRA has often stated that a firm's obligation under Rule 6730 is to report transactions in securities that meet the definition of TRACE-Eligible Security as set forth in Rule 6710(a). In addition, as FINRA has stated previously, if a firm has a reporting obligation under Rule 6730 in a security that is a TRACE-Eligible Security but is not included in the TRACE Issue Master, the firm must notify FINRA immediately and provide the CUSIP and other information necessary for FINRA to update the TRACE Issue Master, which enables the firm to report its transaction to TRACE promptly and comply with its obligations under FINRA Rule 6730.²²

One commenter objected to including as TRACE-Eligible Securities those securities that are not assigned CUSIPs. The commenter stated that the costs of incorporating such securities in TRACE may outweigh the benefits, and that such securities may not contribute meaningfully to price discovery. The commenter requested that FINRA propose amendments to exclude such securities from TRACE if FINRA concludes that securities not assigned a CUSIP represent only a small number of inactively traded securities. FINRA believes that a very limited number of securities may trade without a CUSIP, and in the limited cases where a security is not identified by a CUSIP, FINRA Operations will work with firms to ensure an effective and efficient reporting process.

Some commenters urged FINRA to extend the implementation of the proposed TRACE expansion or to undertake implementation of the expansion of TRACE in phases. ²⁴ FINRA will be mindful of the impact of the proposed changes. FINRA recognizes that the implementation of any significant expansion of a regulatory program creates a number of short-term operational issues that must be addressed and, in addition, a number of permanent modifications that must be made to reporting and other technology

See SIFMA Letter, RBDA Letter, Crews Letter and FIF Letter.

^{21 &}lt;u>See SIFMA Letter and FIF Letter.</u>

Trade Reporting Notice (February 22, 2008).

See FIF Letter.

See SIFMA Letter, FIF Letter and RBDA Letter.

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systems, firm policies and procedures, and compliance programs, among others. FINRA will work with firms to address issues that arise, and firms will be given sufficient notice to modify their reporting systems and make other necessary changes. The effective date of implementation will be announced in a *Regulatory Notice* to be published not later than 60 days after the SEC approves of the proposed rule change, as amended.

Competitive Concerns. A commenter indicated that expanding TRACE to cover Agency Debt Securities may cause competitive disparities between FINRA member firms and bank government securities dealers, which would not be subject to the requirements of the Rule 6700 Series. FINRA notes that the statutory standard requires that FINRA's proposed rules not impose any burden on competition not necessary or appropriate in furtherance of the Securities Exchange Act of 1934 ("Exchange Act"). FINRA clearly believes that it is axiomatic that increased transparency in a securities trading market appropriately furthers the purposes of the Exchange Act. It stands the purposes of the Exchange Act on its head and defeats its purposes by referring to market participants that may not be subject to the Exchange Act in whole or part as a basis for not approving the proposed rule change as such a standard would undo much, if not all, regulation of broker-dealers and markets necessary for the protection of investors and the efficiency, competitiveness and integrity of securities markets. Consequently, FINRA believes these comments are without merit and should not delay the expansion of TRACE as proposed.

Fees. FINRA received comments from two commenters regarding TRACE fees (in addition to fees incurred for "cancels and corrects"). A commenter stated that TRACE fees should be reduced for Agency Debt Securities to the extent that additional TRACE fees are not needed to cover the expenses FINRA incurs for collecting and disseminating TRACE data. A second commenter stated that FINRA should offer corporate bond and Agency Debt Securities market data as a single data set at a price not higher than the current rate for corporate bond market data, and charge lower reporting fees for the reporting of Agency Debt Securities transactions than those charged for corporate bond transactions because dealers make less money per trade in Agency Debt Securities transactions due to narrower bid-ask spreads and smaller dealer markups. FINRA will undertake to review the fee structure for Agency Debt Securities after implementation when FINRA is able to assess accurately the trading volume and demand for Agency Debt Securities data.

See SIFMA Letter.

See SIFMA Letter and RBDA Letter.

See SIFMA Letter.

See RBDA Letter.

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FINRA believes that the foregoing responds to the material issues raised in the comment letters to this rule filing. If you have any questions, please contact me at 202-728-8985 or Sharon.Zackula@finra.org.

Sincerely,

Sharon Zackula

Sharon Backula /py TDN.