

Notice to Members

SEPTEMBER 2003

SUGGESTED ROUTING

Corporate Finance
Legal and Compliance
Operations
Senior Management
Technology
Trading and Market Making
Training

KEY TOPICS

Debt Securities
Dissemination
Operations
Rule 6200 Series
Transaction Reporting

INFORMATIONAL

Corporate Debt Securities Transaction Reporting

NASD Issues Interpretive Guidance to the Trade
Reporting and Compliance Engine Rules (TRACE Rules)

Executive Summary

NASD requires members to report corporate debt securities transactions to NASD and subjects transaction information of certain categories of securities to dissemination pursuant to the Trade Reporting and Compliance Engine (TRACE) rules (TRACE Rules). In this *Notice to Members*, NASD provides guidance on frequently asked questions concerning the reporting of debt securities when par value is not a standard amount and the resubmission of rejected TRACE trade reports under the new 45-minute reporting requirement.

Questions/Further Information

Questions concerning this *Notice* may be directed to tracefeedback@nasd.com; Elliot Levine, Chief Counsel, Market Operations, Regulatory Services and Operations, at (202) 728-8405; or, Sharon K. Zackula, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8985.

Interpretive Guidance

Questions and Answers 1 through 5 address how a member reports bond quantities when the bond traded has a non-standard par value (a par value other than \$1,000 per bond). Question and Answer 6 address the resubmission of rejected trade reports under the new 45-minute reporting requirement, and the rescission of prior guidance on this subject.

03-58

Questions and Answers

Q1. How do I report a baby bond (less than \$1,000 face value per bond)?

A1. Enter the amount in decimal form. Examples: 1/2 a bond = ".50"; a \$512.37 piece of a bond = ".51237."

Q2. How do I report quantity for a bond with a pro-rata sinking fund that has a factor?

A2. The TRACE Rules and the TRACE System include the assumption that one bond is equal to \$1,000 par value. Therefore, the quantity for bonds that involves a factor must be translated into a percentage of \$1,000. Reporting quantity for bonds involving a factor is the same as reporting quantity for a baby bond.

Example: A broker/dealer buys or sells 25 bonds with a pro-rata sinking fund for which the current factor is .300. To determine the quantity for reporting to TRACE, multiply 25 by .300 for a quantity of 7.5 bonds. This results in a remaining principal amount of \$7,500 (at this point in the sinking fund schedule), instead of the original \$25,000.

Q3. How do I report quantity on bonds with par values greater than \$1,000? (Note that two exceptions, GMAC 0 12/1/12 and GMAC 0 6/15/15, are addressed in No. 4)

A3. As noted above, the TRACE Rules and TRACE System assume that one bond has a standard par value, which is \$1,000. When this is not true, and the bond traded has a par value greater than \$1,000, the total par value traded must be translated into \$1,000 equivalents.

Examples:

A bond has a par value of \$2,500. If 20 bonds are bought or sold, the total par value is \$50,000. Divide \$50,000 by \$1,000. Quantity reported to TRACE = 50.

A bond has a par value of \$500,000. If 10 bonds are bought or sold, the total par value is \$5,000,000. Divide by \$1,000. Quantity reported to TRACE = 5,000.

Q4. How do I report quantity and price for GMAC 0 12/1/12 and GMAC 0 6/15/15? These issues trade on the NYSE in units and in prices expressed in hundreds rather than in bond dollars (representing a percentage of par). If I execute OTC, however, how do I report quantity, price, and yield into TRACE?

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- A4. Both the GMAC 0 12/1/12, CUSIP 370424CZ4 (Symbol GMAC.GC) and the GMAC 0 6/15/15 CUSIP 370424DA8 (Symbol GMAC.GD) are exceptions to the norm for reporting to TRACE, since firms may hold these securities differently on their stock records and price can also be expressed in multiple ways. Firms typically settle these trades ex-clearing, with settlement necessitating that both parties use the same standards.

Both issues have par values greater than \$1,000 and a final maturity value of \$10,000. On the New York Stock Exchange (NYSE), both issues are traded in units: one unit = \$10,000. For example, if one unit having a maturity value of \$10,000 trades for a contracted value of \$4,950, a price of \$495 for a quantity of one unit (or one tenth of the contract amount) would be reported to the NYSE. To arrive at the same yield that is posted on the NYSE, market participants can perform a zero-coupon calculation using a workaround solution of entering a dollar price of 49.50 (moving the decimal place an additional place to the left, or one hundredth of the contract amount), which “resembles” bond dollars.

In order to accommodate reporting of these two bonds, the TRACE System adopts the same workaround solution for the calculation of yield to maturity, based upon a “bond-like” price (a price under \$100). The TRACE System assumes a \$1,000 par value; hence, reporting a quantity of one (unit) would be disseminated as \$1,000, which would be both incorrect and misleading. Therefore, since each security trades in increments of \$10,000, the reporting party should report a quantity of 10 for each unit traded. When the transaction information is disseminated, the quantity will appear as 10,000. Report yield to maturity (YTM) only.

Firms executing OTC transactions in either of these issues should submit their TRACE reports according to the example below. Firms reporting through third-party intermediaries should make sure that they can support this methodology; otherwise, reporting will have to be accomplished manually. When reporting through NSCC, the entry should be submitted using a zero-coupon price (*e.g.*, less than 100) and a quantity 10 times the number of units traded (rather than the contract amount). The entry should be marked as a “reporting only” report, so that it will not flow through NSCC’s comparison system. Any possible submissions to NSCC for comparison in these securities should be done separately from the TRACE transaction report.

Example:

One (1) unit is bought, having a maturity value of \$10,000. Reported quantity = 10 and reported price = 49.50. YTM is determined from this price, using the zero-coupon calculation. When disseminated, the quantity reported of one unit will appear as 10,000 traded at 49.50 with the corresponding YTM. (To report the purchase of 4 units, report a quantity of 40.)

Note: Report to TRACE YTM only.

Q5. How do I report commissions for the securities GMAC 0 12/1/12 and GMAC 0 06/15/15, referenced above?

- A5. Commissions in fractions of a point: Because the maturity value of each unit is \$10,000, one point = \$100, rather than the norm of one point = \$10 for a bond with a \$1,000 principal value at maturity. If the commission charged to the customer in the purchase or sale of GMAC 0 12/1/12 or GMAC 0 06/15/15 is one-eighth of a point (.125), this represents \$12.50 per each \$10,000 maturity value. In this example, the member would report .125 in the commission field. If, for example, the price of one unit traded is \$4,950 (on the NYSE, \$495), on TRACE, the price reported is 49.50. Add or subtract the one-eighth of a point (.125) (depending upon whether you sold or bought) to/from the price that will be used to calculate the yield. If selling, the all-inclusive price would be 49.625 (49.50 + .125), with yield to maturity (YTM) calculated from this price. If buying, the all-in price would be 49.375 (49.50 – .125), with YTM calculated from this price.

Flat-fee commissions: If the commission charged to the customer on two units of \$10,000 is \$50, and the price of one unit is \$4,950 (on the NYSE, \$495), then the price reported to TRACE is 49.50, and the commission is reported as .25. If selling, add .25 to 49.50 and calculate YTM from an all-in price of 49.75. If buying, subtract .25 from 49.50, which results in an all-in price of 49.25 with which to calculate YTM.

Q6. When the new TRACE 45-minute reporting period becomes effective, how much time does a member have to resubmit a trade report that was rejected?

- A6. As of October 1, 2003, the period to report a transaction to TRACE will be reduced from 75 minutes to 45 minutes.¹ *As a result, NASD is issuing new guidance, effective as of 8:00 a.m. Eastern Time on October 20, 2003, regarding the resubmission of rejected trade reports, and is withdrawing the guidance issued in NtM 02-76 (November 2002), Question and Answer No. 1 (Q & A 1).*² The guidance issued in NTM 02-76, Q & A 1, is withdrawn as of 8:00 a.m. Eastern Time on October 20, 2003, and, after that time, members should not rely on it.

The period to report a transaction in a TRACE-eligible security will be reduced from 75 minutes to 45 minutes effective October 1, 2003. NASD recognizes, however, that some members may be using a reporting technology that does not immediately relay a message to the member that a transaction report has been rejected. Thus, members may be unaware for a substantial part of the 45-minute reporting period that they must resubmit the trade report.³ Accordingly, in these circumstances, as a general rule, NASD expects that members will correct and resubmit rejected trade reports as soon as practicable, but not later than 90 minutes from the time of execution. (This generally applicable interpretive guidance is referred to hereinafter as the “45-Minute Extension.”)

However, there are three scenarios when a member may not rely on the 45-Minute Extension. The three scenarios are set forth below.

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- a. If a member executes a trade less than 45 minutes before the closing of the TRACE System (on or after 5:45:01 p.m. Eastern Time through 6:29:59 p.m. Eastern Time),⁴ under Rule 6230(a)(1), the member has the option to report the transaction to TRACE the same day, or the next day that the TRACE System is open, within 45 minutes of the opening. In both of these scenarios, a member is not entitled to rely on the 45-Minute Extension to comply with the obligation to timely report.
- i. No Extension of Time Applies: If the member reports the transaction to TRACE before the TRACE System closes and the transaction report is rejected, the member must report the transaction the next day the TRACE System is open, within the first 45 minutes that the System is open in order for the report to be timely. *The 45-Minute Extension does not apply in these circumstances.* For example, a member executes a transaction at 6:10 p.m. Eastern Time on Thursday, the member reports the transaction at 6:29 p.m. Eastern Time, and the transaction report is rejected. On Friday morning, the member must resubmit the corrected transaction report within the first 45 minutes that the TRACE System is open for the report to be timely.
- ii. Fifteen-Minute Extension: If the member opts to first file the transaction report on the next business day that the TRACE System is open, and the transaction report is rejected, the member must correct and resubmit the transaction report as soon as possible and not later than one hour after the TRACE System opens. Stated another way, *the member has 45 minutes to report the transaction and is granted an additional 15 minutes to comply with its reporting obligation. The 45-Minute Extension does not apply in these circumstances.* For example, a member executes a trade at 6:10 p.m. Eastern Time on Thursday, the member first reports the trade on Friday at 8:05 a.m. Eastern Time, and the report is rejected. The member must correct and resubmit the transaction report not later than 8:59:59 a.m. Eastern Time in order for the report to be considered timely filed. The 15-minute extension of time to report is appropriate because members have had time to prepare the transaction report, and should attempt to report outstanding transactions promptly after the TRACE System opens.
- b. Fifteen-Minute Extension: If a member executes a trade when the TRACE System is closed (*e.g.*, on or after 6:30 p.m. Eastern Time on a business day that the TRACE System was open, during a weekend or a holiday, or before 8:00 a.m. Eastern Time on a business day that the TRACE System will open), the member is required under Rule 6230(a)(2) through (4) to report the transaction the first day that the TRACE System is open, within 45 minutes. If the transaction report is rejected, the member must correct and resubmit a transaction report as soon as possible, but not later than one hour after the TRACE System opens. *In this case also, the member has 45 minutes to report the transaction and is granted only an additional 15 minutes to comply with its reporting obligation. In addition, the 45-Minute Extension does not apply.* For example, a member executes a trade at 7:00 p.m. Eastern Time on Thursday. The TRACE System is closed until Friday at 8:00 a.m. Eastern Time. The member first reports the trade on Friday at 8:05 a.m. Eastern Time, and the report is rejected. The member must correct and

resubmit the trade report not later than 8:59:59 a.m. Eastern Time to report on time. The member is permitted to use only an additional 15 minutes to report for the same reasons expressed above.

Regardless of the reporting mechanism used by the member (*e.g.*, batch submission, CTCI, Web browser, third party intermediary reporting systems), any rejected trade reports should be corrected and resubmitted to TRACE as soon as possible by the reporting member. NASD will continue to monitor members' reporting to ensure that members have procedures in place that are reasonably designed to ensure that rejected trade reports are identified, corrected, and resubmitted in a timely manner. Patterns and practices of late submissions due to rejections may be considered a violation of the TRACE Rules and Rule 2110.

Endnotes

- 1 See NtM 03-36 (June 2003).
- 2 Q & A 1 allowed a member, in certain extenuating circumstances, to resubmit rejected trade reports that were "high priority" reports as soon as practicable, but not later than 2 and 1/2 hours after the time of execution of the transaction, and allowed a member to correct and resubmit a "low priority" report as soon as practicable, but not later than the end of the reporting day on the day of execution (or the first business day following the day of execution, if the transaction occurred on a non-business day). High-priority reports were defined as reports of transactions in securities that are subject to dissemination under Rule 6250. Reports of transactions in securities not subject to dissemination under Rule 6250 were low-priority reports. In this guidance, NASD has eliminated these two categories.
- 3 Certain members are using technology that reports transactions to and receives verification of accepted reports back from TRACE via a "batch" process, and this batch process may add time to the identification and correction of trade reports initially rejected by the TRACE System.
- 4 The normal schedule for TRACE System operations is 8:00 a.m. Eastern Time through 6:29:59 p.m. Eastern Time. The times are provided as an example. The actual times may vary if the TRACE System is not operating on a normal schedule.

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