

Notice to Members

MAY 2007

SUGGESTED ROUTING

Legal & Compliance
Market Making
Operations
Registered Representatives
Senior Management
Systems
Trading

KEY TOPICS

Foreign Securities
American Depositary Receipts (ADRs)
Trade Reporting

GUIDANCE

Trade Reporting of Foreign Securities

NASD Provides Guidance Concerning Trade Reporting Obligations for Transactions in Foreign Securities and American Depositary Receipts

Executive Summary

NASD is publishing this *Notice* to provide members with guidance on trade reporting issues involving transactions in foreign securities and American Depositary Receipts (ADRs). NASD is announcing that, on April 20, 2007, NASD filed a rule change with the Securities and Exchange Commission (SEC) for immediate effectiveness to codify existing NASD guidance regarding members' trade reporting obligations for transactions in foreign equity securities.¹ NASD is also publishing this *Notice* to provide guidance to members concerning their trade reporting obligations with respect to certain transactions involving ADRs.

The new rule language is available in Attachment A of this *Notice*.

Questions/Further Information

Questions concerning this *Notice* may be directed to the Legal Section, Market Regulation, at (240) 386-5126; or the Office of General Counsel, at (202) 728-8071.

Discussion

Trade Reporting Obligations for Transactions in Foreign Equity Securities

Pursuant to Rule 6620, NASD members generally are required to report transactions in OTC Equity Securities to NASD's OTC Reporting Facility.² Rule 6610 defines an "OTC Equity Security" as any non-exchange-listed security³ and certain exchange-listed securities that do not otherwise qualify for real-time trade reporting.

The definition of "OTC Equity Security" is broad and includes foreign equity securities, even those that trade exclusively outside the United States. Because of the breadth of this definition, NASD had published guidance that the transaction reporting requirements of Rule 6620 do not apply to transactions in foreign equity securities⁴ if: (1) the transaction is executed on and reported to a foreign securities exchange; or (2) the transaction is executed over the counter in a foreign country and is reported to the regulator of securities markets for that country.⁵ To ensure that all members are aware of their trade reporting obligations regarding foreign equity securities, on April 20, 2007, NASD filed for immediate effectiveness a rule change with the SEC to codify this guidance in NASD Rule 6620(g). The reporting requirements do, however, continue to apply to transactions in foreign equity securities that are executed over the counter in the United States or abroad that are not reported to a foreign exchange or regulator. All such transactions must be reported to NASD.⁶

Trade Reporting Obligations for ADR/Ordinary Swap Transactions

Over-the-counter transactions in ADRs are subject to the trade reporting requirements under NASD rules.⁷ NASD staff recently has received several inquiries relating to trade reporting requirements for ADR swap transactions (sometimes called "cross-book" transactions). In these types of transactions, a firm matches holders of ADRs with holders of the foreign ordinary equity security (referred to as the "ordinary" or "ordinaries") in the same company. To effect the "swap," a firm typically will execute the equivalent of two cross transactions in the two securities between the holders. Because the ADRs and the ordinary shares are separate securities and they are executed in separate transactions, both the ADR and the foreign ordinary share transactions must be reported separately to NASD for public dissemination, as required by NASD rules.

Endnotes

- 1 See Securities Exchange Act Release No. 55745 (May 11, 2007), 72 FR 27891 (May 17, 2007) (SR-NASD-2007-030).
- 2 Transactions in OTC Equity Securities generally must be reported to the OTC Reporting Facility within 90 seconds of execution. Foreign securities (excluding ADRs and Canadian issues), however, may be transmitted to the OTC Reporting Facility by 1:30 on T+1 (or next day) basis regardless of the time of execution.
- 3 A non-exchange-listed security is an equity security that is not traded on any national securities exchange. The term does not include "restricted securities" as defined in SEC Rule 144(a)(3) under the Securities Act of 1933 or any securities designated in the PORTAL Market (NASD Rule 6700 Series). See NASD Rule 6610(c).
- 4 The amendments define a foreign equity security as "any OTC Equity Security that is issued by a corporation or other organization incorporated or organized under the laws of any foreign country."
- 5 See *OTC Bulletin Board Update* (Spec. Ed. Dec. 1993). See also, *NASD Notice to Members 90-58* (Sept. 1990).
- 6 Any transaction reported to NASD must be reported in U.S. dollars, regardless of the currency in which the transaction occurred. The methodology employed by the member for currency conversion is left to the NASD member; however, the member should document its practice and employ the same method consistently.
- 7 See NASD Rules 4632, 4632A, 4632C, 4632D, 4632E, 6620. Members should note, however, that the conversion of ordinary shares into ADRs (or vice versa) at a bank depository, is not considered an OTC transaction for purposes of NASD trade reporting rules and is, therefore, not a reportable event.

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ATTACHMENT A

Below is the text of the rule change. New language is underlined.

6620. Transaction Reporting

(a) through (f) No change.

(g) Transactions in Foreign Equity Securities

(1) For purposes of this paragraph, the term "foreign equity security" means any OTC Equity Security that is issued by a corporation or other entity incorporated or organized under the laws of any foreign country.

(2) Transactions in foreign equity securities shall be reported to the OTC Reporting Facility unless:

(A) the transaction is executed on and reported to a foreign securities exchange; or

(B) the transaction is executed over the counter in a foreign country and is reported to the regulator of securities markets for that country.