

Trade Reporting and Compliance Engine (TRACE)

SEC Approves Exemption from TRACE Reporting Requirements for Certain “Derivative-Related Transactions”

Effective Date: December 13, 2007

Executive Summary

Effective December 13, 2007, “Derivative-Related Transactions” are exempt from the TRACE reporting requirements. Derivative-Related Transactions are transactions in TRACE-eligible securities resulting from the exercise or settlement of an option or a similar instrument, or the termination or settlement of a credit default swap (CDS), other type of swap or a similar instrument. At the same time, FINRA has made conforming amendments to the definition of “reportable TRACE transaction” in NASD Rule 6210(c).¹

The text of NASD Rule 6230(e) and NASD Rule 6210(c), as amended and approved by the SEC on October 26, 2007, is set forth in Attachment A of this *Notice*. Also, FINRA is rescinding NASD Notice to Members (NTM) 05-77 (November 2005), which concerns TRACE reporting requirements for such transactions, effective December 13, 2007.²

Questions regarding this *Notice* may be directed to:

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Notice Type

- ▶ Rule Amendment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Senior Management
- ▶ Systems
- ▶ Trading

Key Topic(s)

- ▶ Derivative-Related Transactions
- ▶ Reportable TRACE Transaction
- ▶ TRACE
- ▶ TRACE-eligible securities
- ▶ Transaction Reporting Exemption

Referenced Rules & Notices

- ▶ NASD Rule 6210
- ▶ NASD Rule 6230
- ▶ NASD NTM 05-77

Background & Discussion

Currently, the TRACE System accepts reports on transactions in TRACE-eligible securities resulting from the exercise or settlement of an option or a similar instrument, or the termination or settlement of a CDS, other type of swap or a similar instrument (collectively, Derivative-Related Transactions). As amended, NASD Rule 6230 exempts such Derivative-Related Transactions from the TRACE reporting requirements.

FINRA determined that Derivative-Related Transactions should be exempt from TRACE reporting because the information regarding price (and yield) being reported to FINRA and disseminated to the public does not reflect currently negotiated transaction prices.³ Further, reporting and dissemination of certain Derivative-Related Transactions does not foster price discovery and may contribute to investor confusion. In addition, because prices from Derivative-Related Transactions do not contribute to price discovery, the costs of continuing to require such reporting, including potential investor confusion, support exempting such transactions from TRACE reporting and dissemination.

In a related amendment to NASD Rule 6210(c), FINRA simplified the defined term, “reportable TRACE transaction,” to exclude generally any transaction exempted under NASD Rule 6230(e).

Because such Derivative-Related Transactions will no longer be reported, FINRA also is rescinding *NASD NTM 05-77* (November 2005), which provides guidance regarding the reporting of such transactions to TRACE. *NASD NTM 05-77* is rescinded effective December 13, 2007.

Endnotes

- 1 See Securities Exchange Act Release No. 56709 (October 26, 2007), 72 FR 61924 (November 1, 2007); File No. SR-FINRA-2007-07.
- 2 See *NASD Notice to Members 05-77* (November 2005).
- 3 For example, the price of a transaction in a TRACE-eligible security executed as a result of the settlement of a CDS is agreed upon at the time of execution of the CDS.

ATTACHMENT A

Below is the text of the rule change. New language is underlined; deletions are in brackets.

6200. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)

6210. Definitions

The terms used in this Rule 6200 Series shall have the same meaning as those defined in [NASD's By-Laws] FINRA's By-Laws and NASD's Rules unless otherwise specified.

(a) through (b) No Change.

(c) The term "reportable TRACE transaction" shall mean any secondary market transaction in a TRACE-eligible security except transactions exempt from reporting as specified in Rule 6230(e). [transactions in TRACE-eligible securities that are listed on a national securities exchange registered under Section 6 of the Securities Exchange Act of 1934, when such transactions are executed on, and reported to the exchange and the transaction information is disseminated publicly.]

(d) through (j) No Change.

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6230. Transaction Reporting

(a) through (d) No Change.

(e) Transactions Exempt From Reporting

The following types of transactions shall not be reported:

(1) through (4) No Change.

(5) Transactions resulting from the exercise or settlement of an option or a similar instrument, or the termination or settlement of a credit default swap, other type of swap, or a similar instrument.

(f) No Change.