

Trade Reporting and Compliance Engine (TRACE)

SEC Approves Amendments Expanding the Definition of “TRACE-Eligible Security”

Effective Date: June 15, 2009

Executive Summary

Effective June 15, 2009, firms must begin reporting transactions in additional TRACE-eligible securities and otherwise comply with all other FINRA Rule 6700 Series requirements regarding such securities.

On April 14, 2009, the SEC approved the amendment that broadens the definition of “TRACE-eligible security”¹ by deleting the following two requirements:

- (1) that TRACE-eligible securities be registered under the Securities Act of 1933 (Securities Act)²; and
- (2) with respect to securities that are resold in a Securities Act Rule 144A transaction,³ that such securities initially be offered and sold under the exemption from registration in Section 4(2) of the Securities Act.⁴

The amended rule extends price transparency to corporate bonds that are being purchased and sold by diverse market participants, including retail investors, and enhances the surveillance of the corporate bond market. The amended rule text is in Attachment A of this *Notice*.

Questions regarding this *Notice* should be directed to:

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Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Executive Representatives
- Fixed Income
- Legal
- Operations
- Sales
- Senior Management
- Systems
- Trading
- Training

Key Topic(s)

- TRACE-Eligible Security
- Transaction Reporting

Referenced Laws & Rules

- FINRA Rule 6710(a)
- Section 3 of the Securities Act
- Section 4(2) of the Securities Act
- Securities Act Rule 144(a)(3)
- Securities Act Rule 144A



Financial Industry Regulatory Authority

Background & Discussion

FINRA Rule 6710(a) currently defines the term “TRACE-eligible security” to mean:

all United States dollar denominated debt securities that are depository eligible securities under NASD Rule 11310(d); Investment Grade or Non-Investment Grade; issued by United States and/or foreign private issuers; and: (1) registered under the Securities Act; or (2) issued pursuant to Section 4(2) of the Securities Act and purchased or sold pursuant to Securities Act Rule 144A. The term “TRACE-eligible security” excludes debt issued by government-sponsored entities, mortgage- or asset-backed securities, collateralized mortgage obligations, and money market instruments. For purposes of the Rule 6700 Series, the term “money market” instrument means a debt security that at issuance has a maturity of one year or less.⁵

The requirements that a TRACE-eligible security either be registered under the Securities Act or, prior to a resale transaction under Securities Act Rule 144A, offered and sold under Section 4(2) of the Securities Act resulted in the exclusion from TRACE of a number of transactions in corporate, dollar-denominated, depository-eligible debt securities, including many securities that are eligible for public sale. Often, such securities are not subject to the TRACE requirements because they are “exempted securities” under Section 3 of the Securities Act and not registered.⁶ For example, transactions in corporate debt securities that are issued subject to the jurisdiction and approval of a court of competent jurisdiction in insolvency matters may be eligible for public sale, but are not reportable to TRACE because they are sold pursuant to an exemption under Section 3 of Securities Act. In addition, certain debt securities issued by banks and other financial institutions are also not TRACE-eligible securities for the same reason. Finally, securities in certain Securities Act Rule 144A transactions are also excluded because such securities initially were not offered and sold under Section 4(2) of the Securities Act. Except for Securities Act Rule 144A transactions, which are sales to certain institutional buyers exclusively, in many cases the securities excluded from TRACE are being purchased and sold by all types of market participants, including retail investors.

The rule change amends the definition of TRACE-eligible security by deleting these two requirements—that a debt security be registered under the Securities Act, or, if resold in a Securities Act Rule 144A transaction, initially offered and sold under Section 4(2) of the Securities Act. In addition, in connection with Rule 144A transactions, instead of requiring that such securities previously be offered and sold under the issuer exemption in Section 4(2) of the Securities Act, FINRA instead provides that if a security is a “restricted security” as defined in Securities Act Rule 144(a)(3),⁷ it is TRACE-eligible if it is sold pursuant to Securities Act Rule 144A. As amended, the definition of TRACE-eligible security provides:

The term “TRACE-eligible security” shall mean all United States dollar denominated debt securities that are depository eligible securities under NASD Rule 11310(d); Investment Grade or Non-Investment Grade; issued by United States and/or foreign private issuers; and, if a “restricted security” as defined in Securities Act Rule 144(a)(3), sold pursuant to Securities Act Rule 144A. The term “TRACE-eligible security” excludes debt issued by government-sponsored entities, mortgage- or asset-backed securities, collateralized mortgage obligations, and money market instruments. For purposes of the Rule 6700 Series, the term “money market instrument” means a debt security that at issuance has a maturity of one year or less.

Firms must begin reporting transactions in the additional TRACE-eligible securities and otherwise comply with all other FINRA Rule 6700 Series requirements regarding such securities as of the effective date. The amended rule extends price transparency to corporate bonds that are being purchased and sold by diverse market participants, including retail investors, and enhances the surveillance of the corporate bond market.

The amendments to FINRA Rule 6710(a) become effective on June 15, 2009.

Endnotes

- 1 See Exchange Act Release No. 59768 (April 14, 2009), 74 FR 18271 (April 21, 2009) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-004).
- 2 15 U.S.C. 77a et seq.
- 3 17 C.F.R. 230.144A.
- 4 15 U.S.C. 77d(2).
- 5 The terms “Investment Grade” and “Non-Investment Grade” are defined in the Rule 6700 Series at Rule 6710(h) and Rule 6710(i), respectively.
- 6 15 U.S.C. 77c.
- 7 Securities Act Rule 144(a)(3) (17 C.F.R. 230.144(a)(3)) defines “restricted securities” as:
 - (i) Securities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or a chain of transactions not involving any public offering;
 - (ii) Securities acquired from the issuer that are subject to the resale limitations of § 230.502(d) under Regulation D or § 230.701(c);
 - (iii) Securities acquired in a transaction or chain of transactions meeting the requirements of § 230.144A; (iv) Securities acquired from the issuer in a transaction subject to the conditions of Regulation CE (§ 230.1001); (v)... ; (vi) Securities acquired in a transaction made under § 230.801 in the same extent and proportion that the securities held by the security holder of the class with respect to which the rights offering was made were, as of the record date for the rights offering, “restricted securities” within the meaning of this paragraph (a)(3); (vii) Securities acquired in a transaction made under § 230.802 to the same extent and proportion that the securities that were tendered or exchanged in the exchange offer or business combination were “restricted securities” within the meaning of this paragraph (a)(3); and (viii) Securities acquired from the issuer in a transaction subject to an exemption under section 4(6) (15 U.S.C. 77d(6)) of the Act.

Attachment A

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

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6700. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)

6710. Definitions

The terms used in this Rule 6700 Series shall have the same meaning as those defined in FINRA's By-Laws and rules unless otherwise specified.

(a) The term "TRACE-eligible security" shall mean all United States dollar denominated debt securities that are depository eligible securities under NASD Rule 11310(d); Investment Grade or Non-Investment Grade; issued by United States and/or foreign private issuers; [and: (1) registered under the Securities Act; or (2) issued pursuant to Section 4(2) of the Securities Act and purchased or] and, if a "restricted security" as defined in Securities Act Rule 144(a)(3), sold pursuant to Securities Act Rule 144A. The term "TRACE-eligible security" excludes debt issued by government-sponsored entities, mortgage- or asset-backed securities, collateralized mortgage obligations, and money market instruments. For purposes of the Rule 6700 Series, the term "money market instrument" means a debt security that at issuance has a maturity of one year or less.

(b) through (j) No Change.

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