

Regulatory Notice

10-26

Trade Reporting

SEC Approves Amendments to Trade Reporting Requirements for Restricted Equity Securities and Revisions to the Definition of OTC Equity Security

Effective Date: June 28, 2010

Executive Summary

Effective June 28, 2010, firms must report transactions in restricted equity securities traded pursuant to SEC Rule 144A to the OTC Reporting Facility no later than 8 p.m. Eastern Time.¹ These reporting requirements replace the trade reporting obligations for restricted equity securities in FINRA's PORTAL rules (FINRA Rule 6630 Series).²

Additionally, FINRA is changing the definition of "OTC Equity Security," which will also be effective on June 28, 2010. The amendments align the term "OTC Equity Security" more closely with SEC rule terminology and improve consistency across the FINRA rulebook. The amendments also clarify the application of the OTC Reporting Facility reporting requirements to transactions reported on or through an exchange.

The text of the amendments is available at www.finra.org/rulefilings/2010-003.

Questions concerning this *Notice* should be directed to:

- The Legal Section, Market Regulation, at (240) 386-5126; or
- The Office of General Counsel at (202) 728-8071.

May 2010

Notice Type

- Rule Amendment

Suggested Routing

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

Key Topics

- OTC Equity Securities
- OTC Reporting Facility
- PORTAL Rules
- Restricted Equity Securities
- Trade Reporting

Referenced Rules & Notices

- FINRA Rule 4560
- FINRA Rule 6420
- FINRA Rule 6610
- FINRA Rule 6622
- FINRA Rule 6630 Series
- FINRA Rule 7410
- SEC Rule 144A



Financial Industry Regulatory Authority

Background & Discussion

On April 23, 2010, the SEC approved several amendments to the reporting provisions regarding the OTC Reporting Facility (ORF).³ The amendments add reporting requirements to the ORF rules regarding transactions in restricted equity securities traded pursuant to Rule 144A under the Securities Act of 1933⁴ (SEC Rule 144A) to replace the reporting requirements in the FINRA PORTAL rules (FINRA Rule 6630 Series) in light of the cessation of the PORTAL Market; revise the definition of “OTC Equity Security” in the FINRA trade reporting rules and improve consistency of the use of the term in the FINRA rulebook; and clarify the scope of the ORF rules with respect to transactions reported on or through an exchange.

Reporting Trades in Restricted Equity Securities

FINRA’s transaction reporting rules for restricted equity securities are currently tied to whether a security is designated for inclusion in the PORTAL Market (*i.e.*, is a “PORTAL security”).⁵ In September 2008, NASDAQ ceased the operation of the PORTAL Market,⁶ and on October 26, 2009, NASDAQ terminated the PORTAL security designation process and removed rules related to the PORTAL Market from its rulebook.⁷ Although securities previously designated as PORTAL securities remained subject to the reporting requirements in the PORTAL rules,⁸ the cessation of the designation of securities as PORTAL securities creates a gap in FINRA’s transaction reporting requirements for restricted equity securities that are traded pursuant to SEC Rule 144A.⁹ To address this gap, effective June 28, 2010, the PORTAL reporting rules are eliminated¹⁰ and the ORF rules include reporting requirements for all equity securities that are defined as “restricted securities” pursuant to Rule 144(a)(3) under the Securities Act of 1933¹¹ and that are traded pursuant to SEC Rule 144A, irrespective of whether they are designated as PORTAL securities. Beginning on that date, transactions in all restricted equity securities effected pursuant to SEC Rule 144A must be reported to the ORF no later than 8 p.m. Eastern Time. Transactions in restricted equity securities effected pursuant to SEC Rule 144A and executed between 8 p.m. and midnight must be reported the following business day (T+1) by 8 p.m.

Definition of “OTC Equity Security”

The amendments described above also change the definition of “OTC Equity Security” in Rule 6420 by deleting the outdated reference to securities that “qualify for real-time trade reporting.” Beginning June 28, 2010, the term is defined as any equity security that is not an “NMS stock” as defined by the SEC in Regulation NMS.¹² The amendments also eliminate the defined term “non-exchange-listed security” from Rule 6420.¹³ Because of these changes, any security or class of securities for which transaction reports are collected, processed and made available pursuant to an effective transaction reporting plan will be excluded from the definition of “OTC Equity Security” in Rule 6420. These changes result in the FINRA definitions being more closely aligned with current SEC rule terminology and more consistent across the FINRA rulebook.¹⁴

Transactions Reported On or Through an Exchange

FINRA also amended the ORF rules to explicitly address transactions in OTC Equity Securities that are executed on an exchange. FINRA's trade reporting rules historically have required that transactions be reported to FINRA only if they were executed "otherwise than on an exchange."¹⁵ The reporting rules for the FINRA/NASDAQ Trade Reporting Facility (TRF), the FINRA/NYSE TRF and the Alternative Display Facility all include an exception from the reporting obligations for transactions reported on or through an exchange and thus require the submission of trade reports to FINRA for transactions in NMS stocks only if the transaction is executed over the counter.¹⁶ The ORF rules, however, have not included a similar exception for transactions in otherwise eligible securities that are reported on or through an exchange.¹⁷ Consequently, FINRA amended Rules 6622, 6420(k) and 6610 to add an exception from the reporting requirements for transactions in OTC Equity Securities reported on or through an exchange.

Endnotes

- 1 Transactions in restricted equity securities effected pursuant to SEC Rule 144A and executed between 8 p.m. and midnight must be reported to the OTC Reporting Facility the following business day (T+1) by 8 p.m.
- 2 The amendments discussed in this *Notice* are limited in scope to restricted equity securities and do not affect the Trade Reporting and Compliance Engine Service (TRACE) or the reporting requirements with respect to any transaction involving debt securities.
- 3 See Securities Exchange Act Release No. 61979 (April 23, 2010), 75 FR 23316 (May 3, 2010) (Order Approving File No. SR-FINRA-2010-003).
- 4 17 CFR 230.144A.
- 5 FINRA created the PORTAL Market in 1990, at the same time the SEC adopted SEC Rule 144A, to serve as a system for quoting, trading and reporting trades in certain designated restricted securities that were eligible for resale under SEC Rule 144A (PORTAL securities). See Securities Exchange Act Release No. 27956 (April 27, 1990), 55 FR 18781 (May 4, 1990). As part of the separation of The Nasdaq Stock Market (NASDAQ) from FINRA, certain functionality relating to the PORTAL Market, including the qualification and designation of PORTAL securities, became part of NASDAQ's rules and were eliminated from the FINRA rules. See Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006).

Endnotes continued

- 6 See Securities Exchange Act Release No. 58638 (September 24, 2008), 73 FR 57188 (October 1, 2008). In addition to NASDAQ ceasing operation of the PORTAL Market, the SEC also approved the deletion of the Depository Trust Company (DTC) requirement that an SEC Rule 144A security, other than investment-grade securities, be included in an "SRO Rule 144A System" in order to be eligible for DTC's deposit, book-entry delivery and other depository services. See Securities Exchange Act Release No. 59384 (February 11, 2009), 74 FR 7941 (February 20, 2009). The PORTAL Market was the only "SRO Rule 144A System." *Id.*
- 7 Securities Exchange Act Release No. 60991 (November 12, 2009), 74 FR 60006 (November 19, 2009).
- 8 Although, as of October 26, 2009, NASDAQ no longer accepted new applications for debt or equity securities seeking PORTAL designation, the termination of this function was not "intended to impact securities previously designated as PORTAL securities or alter any existing regulatory obligation applicable to such securities, including, but not limited to, any trade reporting obligation imposed by any self-regulatory organization." *Id.*
- 9 As noted above, the amendments discussed in this Notice are limited in scope to equity securities and do not affect TRACE or the reporting requirements with respect to any transactions in debt securities.
- 10 In addition to the reporting rules, the PORTAL rules also include FINRA Rule 6635, which specifies those FINRA rules that are and are not applicable to transactions and business activities relating to PORTAL securities. The amendments renumber Rule 6635 as FINRA Rule 6630 to maintain the status quo with respect to the application of FINRA rules to securities previously designated as PORTAL securities prior to October 26, 2009.
- 11 See 17 CFR 230.144(a)(3).
- 12 Regulation NMS defines "NMS stock" as "any NMS security other than an option." 17 CFR 242.600(b)(47). "NMS security" is defined as "any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options." 17 CFR 242.600(b)(46).
- 13 FINRA Rule 6440 (Submission of SEA Rule 15c2-11 Information on Non-Exchange-Listed Securities) and NASD Rule 2320(f), which is often referred to as the Three Quote Rule, will continue to use the term "non-exchange-listed security." Because the amendments delete the term "non-exchange-listed security" from Rule 6420, FINRA added a definition of that term to FINRA Rule 6440 and NASD Rule 2320(f) that is identical to the definition as it appeared in FINRA Rule 6420. Consequently, there is no change in the application of either rule as a result of the amendments.

Endnotes continued

- 14 FINRA amended the definition of “OTC equity security” in Rule 7410 of the Order Audit Trail System (OATS) rules to conform to the new definition used in Rule 6420. The amendments will not result in any change to the scope of securities required to be reported to OATS. In addition, the amendments codify prior FINRA guidance that the OATS rules do not apply to orders for restricted equity securities. *See Regulatory Notice 06-70 n.2* (December 2006). The amendments also eliminate the separate definition of “OTC Equity Security” in FINRA Rule 4560 (Short-Interest Reporting) and clarify that the rule applies to all equity securities except restricted equity securities.
- 15 *See, e.g.*, FINRA Rule 6100, 6200 and 6300 Series.
- 16 *See* FINRA Rules 6282(i)(1)(C), 6380A(e)(1)(C), 6380B(e)(1)(C).
- 17 The ORF rules include an exception for transactions in foreign equity securities when the transaction is executed on and reported to a foreign securities exchange or the transaction is executed over the counter in a foreign country and is reported to the regulator of securities markets for that country. *See* FINRA Rule 6622(g).