Regulatory Notice 11-20

May 2011

Trade Reporting and Compliance Engine (TRACE)

SEC Approves Amendments to Transaction Reporting and Trading Activity Fee Rules Related to the Reporting of Asset-Backed Securities Transactions

Effective Date: May 16, 2011

Executive Summary

The SEC approved proposed amendments to transaction reporting and notification requirements in the FINRA Rule 6700 Series (TRACE rules) and reporting fees in FINRA Rule 7730, which relate primarily to Asset-Backed Securities,[1] and the method of calculating the Trading Activity Fee (TAF) for such securities in Schedule A of the FINRA By-Laws.[2]

The effective date is May 16, 2011. The amended text of Schedule A of the FINRA By-Laws and the rules is set forth at *www.finra.org/notices/11-20*.

Questions regarding this *Notice* should be directed to:

- Brant Brown, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-6927 (regarding TAF);
- Patrick Geraghty, Director, Market Regulation, at (240) 386-4973;
- Elliot R. Levine, Associate Vice President and Counsel, Transparency Services, at (202) 728-8405; or
- Sharon Zackula, Associate Vice President and Associate General Counsel, OGC, at (202) 728-8985.

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal
- Operations
- Senior Management
- Systems
- Trading
- Training

Key Topics

- Asset-Backed Securities
- Notification
- Securitized Products
- TRACE-Eligible Securities
- TRACE Reporting Fees
- Trading Activity Fee
- Transaction Reporting

Referenced Rules & Notices

- FINRA Rule 6710
- FINRA Rule 6730
- FINRA Rule 6760
- FINRA Rule 7730
- FINRA By-Laws, Schedule A, Section 1
- Regulatory Notice 10-55

Financial Industry Regulatory Authority

Background & Discussion

FINRA's TRACE rules provide for the reporting of transactions in TRACE-Eligible Securities to TRACE, and the dissemination of transaction information, with some exceptions. TRACE reporting and data fees are set forth in FINRA Rule 7730. The TAF, a regulatory fee FINRA uses to fund its member regulation activities—which include examinations, financial monitoring and FINRA's policymaking, rulemaking and enforcement activities—is set forth in Schedule A of the FINRA By-Laws.

In February 2010, the SEC approved a rule filing (the TRACE ABS filing)[3] which:

- amends the TRACE rules to classify asset-backed securities, mortgage-backed securities and other similar securities (collectively, Asset-Backed Securities or ABS) as TRACE-Eligible Securities;
- requires that transactions in ABS be reported to TRACE;
- modifies certain other reporting requirements and notification provisions; and
- in FINRA Rule 7730, establishes reporting fees for transactions in ABS.

As previously announced in *Regulatory Notice 10-55* (October 2010), the above-referenced rule changes in the TRACE ABS filing become effective on May 16, 2011.[4]

ABS Technical Corrections Filing

On April 28, 2011, the SEC approved additional amendments to the TRACE rules and FINRA Rule 7730, which, in large part, address issues relating to the reporting of, and fees applicable to, ABS transactions. The amendments to the TRACE rules and FINRA Rule 7730 include:

- adding the defined term "Securitizer"; incorporating minor amendments to clarify, simplify or conform the defined terms "TRACE-Eligible Security," "Reportable TRACE Transaction," "Agency Debt Security," "Asset-Backed Security" and "TRACE System Hours"; and deleting the defined terms "Issuing Entity" and "Sponsor" in FINRA Rule 6710;
- renumbering as FINRA Rule 6730(a)(3) the ABS reporting requirements previously set forth in FINRA Rule 6730(a)(6);
- re-setting the expiration of the Pilot Program for reporting ABS transactions to provide that the Pilot Program will expire on Friday, November 18, 2011, in FINRA Rule 6730(a)(3)(A)(i);
- consolidating and simplifying reporting requirements for ABS transactions that are executed other than during TRACE System Hours in FINRA Rule 6730(a)(3)(B)(ii);

- adding alternative reporting requirements for ABS transactions that are collateralized mortgage obligation (CMO) or real estate mortgage investment conduit (REMIC) transactions that occur prior to the issuance of the CMO or REMIC (called pre-issuance CMOs/REMICs) as:
  1. FINRA Rule 6730(a)(3)(C)(i) during the Pilot Program; and
  2. FINRA Rule 6730(a)(3)(C)(ii) after the expiration of the Pilot Program;
- simplifying how settlement is reported for ABS transactions by deleting the requirement to select an indicator that the transaction will be settled regular way (or not settled regular way) in FINRA Rule 6730(d)(4)(B)(ii);
- adding notification requirements to apply to Securitizers of ABS and alternative notification requirements for pre-issuance CMOs/REMICs in FINRA Rule 6760; and
- adding the Financial Information eXchange (FIX) as a method to report transactions to TRACE and establish a system-related FIX fee in FINRA Rule 7730.

In addition, FINRA incorporates additional minor amendments to the FINRA Rule 6700 Series and FINRA Rule 7730, including renumbering and conforming the text of parallel reporting provisions in FINRA Rule 6730(a).

TAF

On March 4, 2011, the SEC approved amendments to Section 1 of Schedule A to the FINRA By-Laws to provide a method of calculating the TAF for ABS transactions based on the “reported value of the sale” of such securities. Although the method for calculating the TAF will differ among TRACE-Eligible Securities due to differences in how size (volume) is reported to TRACE and TRACE system differences, for all TRACE-Eligible Securities, ultimately, the TAF is assessed based on the size of the transaction.

Currently, when reporting the size (volume) of a transaction other than an ABS, the number of bonds is reported and the TRACE system, which is programmed to reflect that one bond equals $1,000 par value, calculates the size (expressed as total par value) of the transaction (*e.g.*, 10 bonds x $1,000 = $10,000). Based on this reporting structure, the TAF is assessed on a per-bond basis, which indirectly is an assessment based on size, as the number of bonds is a proxy for the size of a transaction in $1,000 increments.

The revisions to Section 1 of Schedule A to the FINRA By-Laws provide a method of calculating the TAF for sales of ABS based on the “reported value of the sale” of the transaction. When a member reports a transaction in an ABS where the par value (or original principal value or original face value) *does not decrease* (or in some circumstances, increase) over time due to the amortization of assets underlying the security, the total par value is reported to TRACE (and not the number of bonds, even if ascertainable) as required under FINRA Rule 6730(d)(2), and the TAF is assessed based upon the total par value reported.[5] However, the requirements to report the size (volume) of an ABS differ if the security amortizes over time. In the sale of an ABS where the original face value (or original principal value) is anticipated to decrease (or increase) over time due to the amortization of assets underlying the security, such as in the sale of a mortgage-backed security, size (volume) is not specifically reported, but is calculated, and the TAF is assessed, by multiplying (a) the reported original face value times (b) the applicable Factor. The Factor is either reported by the member, or, in most cases, is incorporated in the TRACE system by FINRA and not reported by the member as provided in Rule 6730(d)(2).[6] The rate is $0.00000075 times the size of the transaction as reported to TRACE, with a maximum charge of $0.75 per trade.

Effective Date

The changes to the TRACE rules, FINRA Rule 7730 and Section 1 of Schedule A to the FINRA By-Laws become effective on May 16, 2011 (the same day that the rule changes in the TRACE ABS filing become effective).

Endnotes

1 *See* Securities Exchange Act Release No. 64364 (April 28, 2011), 76 FR 25385 (May 4, 2011) (SEC Order Approving File No. SR-FINRA-2011-012).

2 *See* Securities Exchange Act Release No. 64041 (March 4, 2011), 76 FR 13248 (March 10, 2011) (SEC Order Approving File No. SR-FINRA-2011-004).

3 *See* Securities Exchange Act Release No. 61566 (February 22, 2010), 75 FR 9262 (March 1, 2010) (SEC Order Approving File No. SR-FINRA-2009-065) (TRACE ABS filing).

4 *See* Securities Exchange Act Release No. 63223 (November 1, 2010), 75 FR 68654 (November 8, 2010) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2010-054 to Extend the Operational Date of SR-FINRA- 2009-065) and *Regulatory Notice 10-55* (October 2010).

5 For example, the size of a $100,000 par value transaction in an ABS that does not amortize over time is reported to TRACE as $100,000. In contrast, a corporate bond transaction of $100,000 par value is reported to TRACE as 100 bonds. *See* FINRA Rule 6730(d)(2).

6 If an ABS amortizes over time, a member must report the Factor only if the Factor that the member uses to execute the transaction is not the most current Factor publicly available for the ABS at the Time of Execution. When the Factor is the most current Factor publicly available, the member is not required to report it because FINRA incorporates such Factors in the TRACE system. A member must always report the original face value. *See* FINRA Rule 6730(d)(2).