

Regulatory Notice

12-39

Trade Reporting and Compliance Engine (TRACE)

FINRA Requests Comment on TRACE Dissemination Issues

Comment Period Expires: October 10, 2012

Executive Summary

FINRA requests comment on two issues relating to the dissemination of information on TRACE-eligible securities transactions.

First, FINRA seeks input on whether it should maintain or modify current TRACE dissemination caps, under which the actual size (volume) of a transaction over a certain par value is not displayed in disseminated real-time TRACE transaction data. Second, FINRA requests comment on whether transactions in TRACE-eligible securities effected pursuant to Securities Act Rule 144A¹ (Rule 144A transactions) should be disseminated, and if so, the scope and manner of such dissemination.

Questions regarding this *Notice* should be directed to:

- ▶ Elliot R. Levine, Associate Vice President and Counsel, Transparency Services, at (202) 728-8405; or
- ▶ Sharon Zackula, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8985.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by October 10, 2012.

Member firms and other interested parties can submit their comments using the following methods:

- ▶ Emailing comments to pubcom@finra.org; or

September 2012

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Fixed Income
- ▶ Legal
- ▶ Trading

Key Topics

- ▶ Dissemination Caps
- ▶ Rule 144A Transactions
- ▶ TRACE Dissemination
- ▶ TRACE-Eligible Security

Referenced Rules & Notices

- ▶ FINRA Rule 6710
- ▶ FINRA Rule 6750
- ▶ Securities Act Section 3
- ▶ Securities Act Section 5
- ▶ Securities Act Rule 144A



Financial Industry Regulatory Authority

- ▶ Mailing comments in hard copy to:
Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, D.C. 20006-1506

To help FINRA process and review comments more efficiently, persons should only use one method to comment on the proposal.

Important Notes: The only comments FINRA will consider are those submitted using the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA website. Generally, FINRA will post comments as they are received.²

Background & Discussion

Dissemination Caps

As part of the initial TRACE implementation in July 2002, FINRA established dissemination protocols that included certain caps. Disseminated TRACE transaction data includes price, time of execution, size and other information. The size disseminated is the total par value of the trade, subject to the limits of the applicable dissemination cap.

- ▶ For investment grade TRACE-eligible securities and agency debt securities, the current dissemination cap is \$5 million, and a transaction in excess of \$5 million is disseminated as "\$5MM+."³
- ▶ For non-investment grade TRACE-eligible securities, the current dissemination cap is \$1 million, and a transaction in excess of \$1 million is disseminated as "\$1MM+."⁴

FINRA recently announced additional caps as part of the dissemination of transaction information on agency pass-through mortgage-backed securities traded to be announced (TBA transactions).⁵ FINRA will begin disseminating TBA transactions on November 5, 2012.

- ▶ For TBA transactions eligible "for good delivery," the dissemination cap is \$25 million, and a transaction in excess of \$25 million will be disseminated as "\$25MM+."
- ▶ For TBA transactions "not for good delivery," the dissemination cap is \$10 million, and a transaction in excess of \$10 million will be disseminated as "\$10MM+."⁶

Discussion

FINRA periodically evaluates current practices and seeks input on modifications that may be beneficial. FINRA seeks comment as to whether to modify, leave unchanged or eliminate the \$1 million and \$5 million TRACE volume dissemination caps, which have been in place since TRACE began operating on July 1, 2002. As part of a broader effort to review dissemination practices, FINRA also seeks comment on the caps for TBA transactions that become effective on November 5, 2012.

Most firms have comprehensive policies and procedures for TRACE compliance, and regularly use TRACE data for pricing purposes, as well as for internal supervisory purposes. Providing transaction data showing the actual trade size may assist all market participants in determining the quality of their executions and member firms in complying with their best execution obligations. In addition, the dissemination of transaction data showing actual trade size may have a positive impact on the quality of pricing for valuation purposes.

The following tables show the percentage of transactions in TRACE-eligible securities reported to TRACE—excluding asset-backed securities—by total par value and trade count, that are effected at various sizes, and the impact of the \$5 million dissemination cap (for investment grade and agency debt securities) and \$1 million dissemination cap (for non-investment grade securities) on the percentage of par value and trades for which actual size is above the indicated cap level and therefore not displayed in disseminated data. The tables also show the impact of dissemination caps if set at alternative levels.⁷

INVESTMENT GRADE CORPORATE BONDS		NON-INVESTMENT GRADE CORPORATE BONDS		AGENCY DEBT SECURITIES	
Percentage of Par Value Traded Above Cap Level		Percentage of Par Value Traded Above Cap Level		Percentage of Par Value Traded Above Cap Level	
Cap Level	Percentage	Cap Level	Percentage	Cap Level	Percentage
\$1 million +	83.17%	\$1 million + <i>Current Level</i>	79.49%	\$1 million +	94.14%
\$5 million + <i>Current Level</i>	48.91%	\$5 million +	36.39%	\$5 million + <i>Current Level</i>	77.20%
\$10 million +	30.49%	\$10 million +	23.03%	\$10 million +	66.01%
\$15 million +	22.99%	\$15 million +	18.39%	\$15 million +	60.07%
\$20 million +	17.84%	\$20 million +	15.22%	\$20 million +	54.99%
\$25 million +	14.10%	\$25 million +	12.89%	\$25 million +	47.42%
\$50 million +	7.23%	\$50 million +	8.06%	\$50 million +	31.50%
\$75 million +	5.19%	\$75 million +	6.59%	\$75 million +	26.93%
\$100 million +	3.90%	\$100 million +	5.49%	\$100 million +	20.36%
Percentage of Trades Above Cap Level		Percentage of Trades Above Cap Level		Percentage of Trades Above Cap Level	
Cap Level	Percentage	Cap Level	Percentage	Cap Level	Percentage
\$1 million +	8.08%	\$1 million + <i>Current Level</i>	10.85%	\$1 million +	23.90%
\$5 million + <i>Current Level</i>	1.81%	\$5 million +	1.43%	\$5 million + <i>Current Level</i>	8.34%
\$10 million +	0.64%	\$10 million +	0.46%	\$10 million +	4.65%
\$15 million +	0.35%	\$15 million +	0.26%	\$15 million +	3.40%
\$20 million +	0.21%	\$20 million +	0.16%	\$20 million +	2.64%
\$25 million +	0.13%	\$25 million +	0.11%	\$25 million +	1.76%
\$50 million +	0.03%	\$50 million +	0.03%	\$50 million +	0.63%
\$75 million +	0.02%	\$75 million +	0.02%	\$75 million +	0.43%
\$100 million +	0.0080%	\$100 million +	0.0105%	\$100 million +	0.23%

The following tables show the percentage of TBA transactions reported to TRACE, by total par value and trade count, that are effected at various sizes, and the impact the \$25 million dissemination cap (for TBA transactions eligible “for good delivery”) and the \$10 million dissemination cap (for TBA transactions “not for good delivery”) (based on historical transaction data) would have had on the percentage of par value traded and trades for which the actual size would not have been displayed (if such transactions had been disseminated during that period).⁸ The tables also show the impact of dissemination caps if set at alternative levels.

TBA GOOD DELIVERY	
Percentage of Par Value Traded Above Cap Level	
Cap Level	Percentage
\$10 million +	92.40%
\$25 million + <i>Current Level</i>	84.17%
\$50 million +	74.20%
\$75 million +	69.37%
\$100 million +	57.70%
\$250 million +	33.82%
\$500 million +	17.40%
Percentage of Trades Above Cap Level	
Cap Level	Percentage
\$10 million +	32.79%
\$25 million + <i>Current Level</i>	20.13%
\$50 million +	12.45%
\$75 million +	10.04%
\$100 million +	6.19%
\$250 million +	1.87%
\$500 million +	0.51%

TBA NOT GOOD DELIVERY	
Percentage of Par Value Traded Above Cap Level	
Cap Level	Percentage
\$10 million + <i>Current Level</i>	84.53%
\$25 million +	54.71%
\$50 million +	23.52%
\$75 million +	15.50%
\$100 million +	10.11%
\$250 million +	2.68%
\$500 million +	0.00%
Percentage of Trades Above Cap Level	
Cap Level	Percentage
\$10 million + <i>Current Level</i>	41.47%
\$25 million +	15.98%
\$50 million +	3.80%
\$75 million +	1.80%
\$100 million +	0.90%
\$250 million +	0.12%
\$500 million +	0.00%

Rule 144A Transactions

Securities Act Rule 144A is a safe harbor exemption from the registration requirements of Securities Act Section 5 for certain offers and sales of qualifying securities by certain persons other than the issuer of the securities. The exemption applies to the re-sale of securities to qualified institutional buyers (QIBs).⁹ Rule 144A transactions have been subject to TRACE reporting requirements since TRACE inception. Unlike transactions in publicly traded bonds, Rule 144A transactions are not subject to dissemination because of the private nature of the transactions.¹⁰ However, this approach results in limited or no price transparency in the market in Rule 144A TRACE-eligible securities. Without any disseminated data, it may be difficult for market participants to assess the quality of the executions of their orders and for firms to determine if they have complied with their best execution obligations. In addition, the lack of disseminated data in Rule 144A transactions may have an adverse impact on the accurate valuation of positions in such securities.

FINRA seeks comment on the current approach and whether Rule 144A transactions should be subject to dissemination. FINRA notes that Rule 144A transactions account for approximately 4 percent of trades and 18 percent of par value in corporate debt securities reported to TRACE. The table below summarizes the percentage of all TRACE corporate debt trades, all TRACE non-investment grade corporate debt trades and all TRACE investment grade corporate debt trades that are Rule 144A trades.¹¹

	July 2011 Through June 2012
Rule 144A trades as a percentage of total TRACE corporate trades	4.37%
Rule 144A non-investment grade trades as a percentage of all TRACE non-investment grade trades	8.09%
Rule 144A investment grade trades as a percentage of all TRACE investment grade corporate trades	2.50%
Rule 144A par value traded as a percentage of total TRACE corporate par value traded	17.53%
Rule 144A non-investment grade par value traded as a percentage of all TRACE non-investment grade corporate par value traded	20.59%
Rule 144A investment grade par value traded as a percentage of all TRACE investment grade corporate par value traded	14.89%

If Rule 144A transactions were disseminated and dissemination caps were applied, the following tables show the percentages of Rule 144A transactions (and par value traded) that would be subject to various dissemination cap levels.

July 2011 Through June 2012	
INVESTMENT GRADE RULE 144A	
Percentage of Par Value Traded Above Cap Level	
Cap Level	Percentage
\$1 million +	94.02%
\$5 million +	64.30%
\$10 million +	47.22%
\$15 million +	39.48%
\$20 million +	33.58%
\$25 million +	28.40%
\$50 million +	18.01%
\$75 million +	14.70%
\$100 million +	12.48%
Percentage of Trades Above Cap Level	
Cap Level	Percentage
\$1 million +	50.68%
\$5 million +	13.28%
\$10 million +	5.52%
\$15 million +	3.38%
\$20 million +	2.23%
\$25 million +	1.44%
\$50 million +	0.42%
\$75 million +	0.23%
\$100 million +	0.15%

July 2011 Through June 2012	
NON-INVESTMENT GRADE RULE 144A	
Percentage of Par Value Traded Above Cap Level	
Cap Level	Percentage
\$1 million +	89.41%
\$5 million +	44.63%
\$10 million +	30.57%
\$15 million +	25.07%
\$20 million +	21.20%
\$25 million +	18.42%
\$50 million +	12.22%
\$75 million +	9.93%
\$100 million +	8.01%
Percentage of Trades Above Cap Level	
Cap Level	Percentage
\$1 million +	51.47%
\$5 million +	7.35%
\$10 million +	2.61%
\$15 million +	1.51%
\$20 million +	0.96%
\$25 million +	0.66%
\$50 million +	0.21%
\$75 million +	0.12%
\$100 million +	0.06%

Request for Comment

FINRA welcomes all comments on the use of dissemination caps and the dissemination of Rule 144A transactions. FINRA also specifically requests comment on the issues identified below.

Dissemination Caps for Investment Grade and Non-Investment Grade Debt Securities

1. What would be the impact of raising the dissemination caps for:
 - a. investment grade TRACE-eligible securities transactions to \$10 million, \$15 million, \$20 million or higher; and
 - b. non-investment grade TRACE-eligible securities transactions to \$5 million, \$10 million, \$20 million or higher?
2. Should FINRA set a dissemination cap applicable solely to agency debt securities in light of the larger size of many transactions in such securities?
 - a. If so, should it be set at \$25 million, \$50 million, \$100 million or higher?
3. Should there continue to be different dissemination caps for investment grade and non-investment grade debt securities?
4. Should the dissemination caps for investment grade and non-investment grade debt securities be eliminated entirely?
5. Would the information available as a result of higher dissemination caps allow broker-dealers and institutional investors to better value positions?
6. Could alternative ways of determining dissemination caps—for example, by dollar value¹² of transaction rather than par value—provide meaningful trade volume exposure while still limiting the transaction sizes displayed through the caps?

Dissemination Caps for TBA Transactions

1. Should there be a dissemination cap for TBA transactions?
 - a. If yes, are the levels appropriate or should higher or lower caps be considered?

Rule 144A Transactions

1. Should Rule 144A transactions—private re-sales of securities to QIBs—be subject to dissemination?
2. If yes, should Rule 144A transactions be subject to dissemination in the same manner as other disseminated transactions in TRACE-eligible securities?
 - a. If yes, should they be disseminated subject to a dissemination cap?
 - b. If yes, what is the appropriate size (volume) at which to set the dissemination cap?

- c. If yes, should FINRA distinguish between investment grade and non-investment grade securities, and set a higher dissemination cap for Rule 144A transactions in investment grade securities and a lower dissemination cap for Rule 144A transactions in non-investment grade securities?
- 3. Would dissemination of Rule 144A transaction information impact investment decisions and price negotiations, and, if yes, how?
- 4. If information on Rule 144A TRACE-eligible securities transactions should be disseminated, should the transaction information be disseminated publicly without limitation or on a more limited basis?

Endnotes

1. 17 CFR 239.144A.
2. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See [Notice to Members 03-73](#) (November 2003) (NASD Announces Online Availability of Comments) for more information.
3. The term investment grade is defined in FINRA Rule 6710(h). In most cases, an agency debt security that is not rated is traded and priced as an investment grade security. Thus, for purposes of TRACE, in most cases, such securities are classified as investment grade debt and subject to the \$5MM+ dissemination cap. The term agency debt security is defined in FINRA Rule 6710(l).
4. The term non-investment grade is defined in FINRA Rule 6710(i). For purposes of TRACE, most unrated corporate bonds are considered non-investment grade debt and are subject to the \$1MM+ dissemination cap.
5. The terms agency pass-through mortgage-backed security and to be announced are defined in, respectively, FINRA Rule 6710(v) and FINRA Rule 6710(u). See Securities Exchange Act Release No. 66829 (April 18, 2012), 77 FR 24748 (April 25, 2012) (SEC Approval Order Relating to Post-Trade Transparency of Agency Pass-Through Mortgage-Backed Securities Traded TBA) (TBA Dissemination Approval Order); [Regulatory Notice 12-26](#) (May 2012) (announcing November 5, 2012, as the effective date for the dissemination of TBA transactions, dissemination caps for such TBA transactions, and related rule changes).
6. See FINRA Rule 6710(u) (as effective on November 5, 2012) for reference to the terms “for good delivery” and “not for good delivery.” See also [Regulatory Notice 12-26](#) and TBA Dissemination Approval Order.
7. FINRA calculated the percentages based on the 12-month period from July 1, 2011, to June 30, 2012.
8. See *supra* note 5.

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9. Qualified institutional buyer is defined in Securities Act Rule 144A(a)(1). 17 CFR 239.144A(a)(1).
10. See FINRA Rule 6750(b)(1).
11. FINRA calculated the percentages based on the 12-month period from July 1, 2011, to June 30, 2012.
12. For this discussion, the dollar value of the transaction means the par value multiplied by the execution price of the transaction.