

Trade Reporting Notice

Frequently Asked Questions Regarding TRACE Reporting

Executive Summary

FINRA addresses several trade reporting issues in connection with reporting transactions in TRACE-eligible securities to the Trade Reporting and Compliance Engine (TRACE) system. This *Notice* addresses the following topics:

- ▶ split-volume reporting;
- ▶ reporting investment adviser-directed transactions;
- ▶ reporting Securities Act Regulation S transactions;
- ▶ transfers establishing the underwriting syndicate;
- ▶ firm commitments prior to final pricing;
- ▶ transfers facilitating settlement; and
- ▶ reporting collateralized mortgage obligations.

Questions concerning this *Notice* should be directed to:

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- ▶ Elliot Levine, Associate Vice President and Counsel, TRACE, at (202) 728-8405; or
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Key Topics

- ▶ Allocations
- ▶ Collateralized Mortgage Obligations
- ▶ Investment Advisors
- ▶ Managed Accounts
- ▶ Settlement
- ▶ Underwriting

Referenced Rules & Notices

- ▶ FINRA Rule 6710
- ▶ FINRA Rule 6730
- ▶ FINRA Rule 6760
- ▶ Securities Act Regulation S

Discussion

FINRA addresses several trade reporting issues in connection with reporting transactions in TRACE-eligible securities to the TRACE system. The questions and answers in this *Notice* will be incorporated in the [Reporting of Corporate and Agencies Debt FAQ](#) and the [Reporting of Mortgage and Asset Backed Securities \(Securitized Products\) FAQ](#).

Reporting of Corporate and Agencies Debt FAQ

Split-Volume Reporting

- Q. How should a firm report the size (volume) of its purchase from another firm when the bonds will be allocated subsequently to multiple customer accounts, totaling the aggregate purchase amount?**
- A. If the transaction between two member firms was agreed upon at the aggregate amount, both firms should report the aggregate amount as the size (volume) to TRACE. For example, if Firm A sells \$100,000 (par value) to Firm B, which in turn executes 10 sales to customers at \$10,000 each, Firm A should report a sale of \$100,000 to Firm B and Firm B should report a purchase of \$100,000 from Firm A. Firm B also should report 10 sales to customers of \$10,000 each. Firm B *should not* report 10 purchases of \$10,000 each from Firm A in order to match its 10 sales to customers at \$10,000 each.

Investment Adviser Transactions

FINRA has received a number of questions about the reporting requirements under TRACE rules applicable to managed accounts, where broker-dealers (BD) receive orders and allocation instructions from investment advisers (IA).

- Q. How should a BD report a transaction to TRACE where an IA places a block order with the BD and instructs the BD to allocate the block order to various managed customer accounts?**
- A. The response depends on whether the BD and IA are the same or separate entities. See the examples below.

Scenario 1: BD A is registered both as a BD under the Securities Exchange Act of 1934 and an IA under the Investment Advisers Act of 1940 (or is regulated as an IA in the state in which it maintains its principal office and place of business) and operates as one legal entity. For certain managed customer account(s), BD/IA A directs its trading desk to purchase a block of \$100 million (par value) bonds from the Street (or otherwise obtain the bonds). BD/IA A then sells portions of the block (in accordance with the allocation instructions) to various managed customer accounts of BD/IA A, which are maintained at BD/IA A.

TRACE Reporting: BD/IA A reports the purchase (from the Street or another source) of the \$100 million bonds to TRACE, including the time of execution of the block. BD/IA A also reports the sale(s) to the various managed customer accounts, which must include any markup or commission, to TRACE. When reporting the sales of securities to the various managed customer accounts, the time of execution is the time the material terms of the transaction are determined. If BD/IA A finalizes the allocation with respect to each managed customer account (thereby establishing the material terms of the transaction as to each customer) before or at the same time it submits the block order to its trading desk (to purchase from the Street), the time of execution of the sales to individual managed customer accounts is the same time of execution reported for the block purchase. If such allocations (as to the material terms with respect to each managed customer account) are not finalized before or at the same time as the block order (to purchase from the Street), the time of execution of the sales to individual managed customer accounts is the time such allocations are finalized.

Scenario 2: BD A is registered as a BD, but is not an IA. An IA in a separate legal entity (including an IA that is an affiliate of BD A or an IA selected from a list of IAs that BD A “approved”) places an order with BD A to purchase a \$100 million block of bonds, and instructs BD A to retain eighty percent (\$80 million) for allocation to various managed customer accounts maintained at BD A, and to deliver twenty percent (\$20 million) to BD B, which will be allocated to various customer accounts maintained at BD B. After the execution of the order, the IA then allocates the portion of the block retained by BD A (\$80 million) to various managed customer accounts maintained at BD A. Separately, the IA allocates the portion of the block delivered to BD B (\$20 million) to various managed customer accounts maintained at BD B.

TRACE Reporting: BD A reports the purchase of the \$100 million block to TRACE. BD A also reports the block sale (\$100 million) to the IA (as a sale to a “C” (customer)). BD A does not report to TRACE the transfer (in accordance with the allocation instructions from the IA) to the various managed customer accounts that are managed by the IA and maintained at BD A. Similarly, BD B does not report to TRACE the transfer (in accordance with the allocation instructions from the IA) to various managed customer accounts that are managed by the IA and maintained at BD B. Consistent with FAQ #1.28, the transfer of the bonds (\$20 million) from BD A to BD B also is not separately reported to TRACE as FINRA considers this a “step-out” transaction whereby the executing broker may deliver all or part of a block of securities to another broker-dealer and the only reportable event is the transaction between the executing firm and its customer. The broker-dealer that has stepped in performs nothing more than a clearing function and does not have a reporting obligation.

Regulation S

Q. If a debt security is sold pursuant to Regulation S in an off-shore transaction, is a member firm required to report the transaction to TRACE?

- A. No. In 2009, FINRA expanded the definition of TRACE-eligible security in Rule 6710(a).¹ When the amendments took effect, many securities that previously were not TRACE-eligible securities, including debt securities that were distributed other than pursuant to a registration statement, became TRACE-eligible securities. However, the definition of TRACE-eligible security was not expanded to include debt securities distributed in bona fide off-shore Regulation S transactions.

For purposes of TRACE reporting, FINRA distinguishes between debt securities that are the subject of bona fide Regulation S transactions and subsequent non-Regulation S transactions in such debt securities. Thus, if a debt security originally sold in a Regulation S transaction is subsequently purchased or sold as part of a U.S. transaction, the transactions following the Regulation S transaction must be reported to TRACE. FINRA notes that such transactions are subject to TRACE reporting whether the transactions occur during or after the applicable Regulation S distribution compliance period.

Establishing the Underwriting Syndicate

FINRA is amending and replacing in its entirety the current FAQ #4.19.

Q. Are transfers of TRACE-eligible securities among syndicate members for purposes of establishing the underwriting syndicate reportable to TRACE?

- A. No, a transfer of TRACE-eligible securities on the first day of trading from one member of the underwriting syndicate to another member of the underwriting syndicate that is done *solely* to facilitate the establishment of the syndicate is not reportable to TRACE. For example, when all the securities for an offering are delivered on the first day of trading by the issuer to one of the co-managers of the syndicate with the understanding that the firm will deliver a portion of the securities to the second co-manager to establish the syndicate, the transfer is not reportable to TRACE. FINRA reminds firms that engage in such transfers of the need to maintain and retain (*e.g.*, for examiner review) accurate records sufficient to demonstrate that the transfers were effected to facilitate the establishment of the syndicate.

FINRA notes that this guidance does not extend to transfers of TRACE-eligible securities from a managing underwriter (or another member of the underwriting syndicate) to selling group members. Such transfers must be reported to TRACE. Also, this guidance does not extend to *re-allocations*, which would include transfers to syndicate members after the first day of trading. If a re-allocation occurs among syndicate members after the initial allocation is established, the transfer of such securities from one firm to another firm to effect the reallocation must be reported to TRACE.

Firm Commitments Prior to Final Pricing

Q. If, prior to the final pricing or determination of other material terms of a new issue debt security, a firm receives a firm commitment from a broker-dealer or a customer to purchase the new issue debt security when it is issued, has the firm entered into a transaction that must be reported to TRACE?

A. No. Although firms may solicit orders or seek indications of interest from customers and other broker-dealers, and, in some instances, receive a firm commitment from a broker-dealer or a customer to purchase a quantity of a new debt security prior to its issuance and the determination of final material terms (*e.g.*, price, coupon and quantity), for purposes of TRACE trade reporting, a transaction occurs at the “time of execution” as defined in FINRA Rule 6710(d), which does not occur until the parties have a “meeting of the minds” regarding the material terms of the transaction. This “meeting of the minds” cannot occur *before* the final material terms, such as price, coupon and quantity, have been established by the issuer and such terms are known by the parties to the transaction. Further, firms are reminded they should be clear in their communications regarding the final terms of the trade and how such terms will be conveyed between the parties.

Facilitating Settlement

The following FAQ was originally included in the Reporting section (FAQ #11) of the Reporting of Mortgage and Asset Backed Securities (Securitized Products) FAQ. FINRA has amended the FAQ and is replacing it in its entirety with the following:

Q. Are transfers of TRACE-eligible securities among syndicate members for purposes of facilitating settlement reportable to TRACE?

A. No. If a transfer of TRACE-eligible securities is done *solely* to facilitate settlement with no change in price or other material terms, transfers from one member of a syndicate to another syndicate member would not be reportable to TRACE. For example, if a customer purchases bonds from multiple syndicate members, but designates one syndicate member to deliver the entire allotment, the transfer of the bonds to the designated syndicate member from the other syndicate members would not be reported to TRACE as long as there is no change in price or other material terms.

In addition, if the syndicate members designate one syndicate manager or another syndicate member to act as a billing and delivery agent and the agent is used to sell or deliver the securities to all “end” investors on behalf of the syndicate, the transfer of the securities from syndicate members to the billing and delivery agent also would not be reportable to TRACE in that such transfers occur *solely* for administrative convenience (*i.e.*, to facilitate the creation and maintenance of accurate books and records). FINRA reminds firms that engage in these types of transactions of the need to maintain and retain (*e.g.*, for examiner review) accurate records sufficient to demonstrate that such transfers are effected to facilitate settlement.

Reporting of Mortgaged-Backed Securities (Securitized Products) FAQ

Collateralized Mortgage Obligations (CMO) and Real Estate Mortgage Investment Conduits (REMIC)

- Q.** Under FINRA Rule 6730(a)(3)(C), a firm must report a CMO or REMIC transaction on the earlier of the business day that the security is assigned a CUSIP, a similar numeric identifier or a FINRA symbol, or the date of issuance of the security. When the event triggering the reporting requirement is the “business day that the security is assigned a CUSIP,” if the final structure of the CMO has not been determined or the CUSIP is not yet publicly available, is the reporting requirement triggered?
- A.** No. FINRA interprets the phrase “the business day the security is assigned a CUSIP” to mean that the CUSIP is assigned and publicly available and the final structure of the CMO or REMIC has been determined. If these conditions are met, then the reporting requirement is triggered.
- Q.** Under Rule 6760, notice must be provided to TRACE regarding a CMO or a REMIC when transactions are effected prior to the issuance of the security “on the date of issuance” or upon the occurrence of an “other event that establishes the reference date that determines when a reporting period begins under Rule 6730(a)(3)(C).” As noted above, an “other event” includes “the business day that the security is assigned a CUSIP. . .” Does FINRA interpret the phrase “the business day that the security is assigned a CUSIP” in the same manner the phrase is interpreted under Rule 6730(a)(3)(C)?
- A.** Yes, FINRA interprets the phrase “the business day that the security is assigned a CUSIP” in the same manner the phrase is interpreted under Rule 6730(a)(3)(C). As a result, in most cases, “the business day that the security is assigned a CUSIP” is the same date the final offering document/prospectus becomes available to underwriters/initial purchasers.

On that date, the managing underwriter (or other person designated under Rule 6760) has an obligation to provide notice and information to FINRA regarding the TRACE-eligible security as provided in FINRA Rule 6760(c)(2). FINRA notes that the date that the final offering document/prospectus becomes available to underwriters (or initial purchasers) is referred to as the “print date” by certain government-sponsored enterprises.

An underwriter must submit information regarding the security as required in Rule 6760(b) in accordance with the FINRA new issue form for ABS/CMO, and should refer to the Instructions for the ABS/CMO new issue form and the definitions and examples provided for each field.

In addition to notifying FINRA under Rule 6760, FINRA encourages underwriters to inform participants in the offering of the final structure of the CMO or REMIC, and when the CMO or REMIC security has been added to TRACE and is available for trade reporting.

Endnote

1. Securities Exchange Act Release No. 59768 (April 14, 2009), 74 FR 18271 (April 21, 2009) (SEC approval order for File No. SR-FINRA-2009-004).