

## Trade Reporting

### FINRA Issues an Interpretation to Clarify the Classification and Trade Reporting of Certain “Hybrid” Securities to FINRA

Effective Date: June 16, 2014

#### Executive Summary

FINRA is publishing this *Notice* to provide additional information on how trades in certain securities that have both debt- and equity-like features (hybrid securities) must be reported to FINRA. Specifically, the SEC approved an interpretation regarding the appropriate trade reporting facility to which firms should report transactions in the following three types of hybrid securities: (1) unlisted depositary shares having a liquidation preference of \$1,000 or more; (2) unlisted non-convertible, preferred securities having a liquidation preference of \$1,000 or more; and (3) unlisted capital trust securities (also referred to as trust preferred securities) (together, “covered hybrid securities”).<sup>1</sup>

In accordance with this interpretation, on June 16, 2014, firms will be required to report transactions in covered hybrid securities to the Trade Reporting and Compliance Engine (TRACE). However, firms may request the set-up of a new hybrid security for trade reporting purposes in accordance with this interpretation prior to that date. A list of covered hybrid securities that will be moved from the OTC Reporting Facility (ORF) to TRACE on June 16, 2014, is attached as Appendix A.

Questions regarding this *Notice* should be directed to:

- ▶ Ola Persson, Vice President, Transparency Services, at (212) 858-4796 or by [email](#); or
- ▶ Racquel Russell, Associate General Counsel, Office of General Counsel, at (202) 728-8363 or by [email](#).

#### May 2014

##### Notice Type

- ▶ Guidance

##### Suggested Routing

- ▶ Compliance
- ▶ Fixed Income
- ▶ Legal
- ▶ Operations
- ▶ Systems
- ▶ Trading
- ▶ Training

##### Key Topics

- ▶ Capital Trust Security
- ▶ Depositary Shares
- ▶ Hybrid Security
- ▶ Over-the-Counter Reporting Facility
- ▶ Preferred Shares
- ▶ TRACE
- ▶ Transaction Reporting
- ▶ Trust Preferred Security

##### Referenced Rules & Notices

- ▶ FINRA Rule 6420
- ▶ FINRA Rule 6622
- ▶ FINRA Rule 6700 Series
- ▶ FINRA Rule 6710
- ▶ Regulation NMS
- ▶ Regulation NMS Rule 600(b)(47)
- ▶ Regulatory Notice 08-72
- ▶ SEA Rule 144(a)(3)
- ▶ SEA Rule 144A
- ▶ SEA Section 31
- ▶ Section 3 of Schedule A to the FINRA By-Laws

## Background and Discussion

FINRA trade reporting rules generally require that firms report over-the-counter (OTC) transactions in debt securities that are “TRACE-Eligible Securities”<sup>2</sup> and equity securities to FINRA. FINRA Rule 6622 requires that firms report OTC transactions in “OTC Equity Securities”<sup>3</sup> to ORF and the FINRA Rule 6700 series requires firms to report transactions in TRACE-Eligible Securities to TRACE.

In consultation with the industry, FINRA has determined that the term “TRACE-Eligible Security” includes the following covered hybrid securities (and thus these securities should be reported to TRACE):<sup>4</sup>

1. unlisted capital trust and trust preferred securities;<sup>5</sup>
2. unlisted depositary shares having a liquidation preference of \$1,000 or more (or a cash redemption price of \$1,000 or more) that is a fractional interest in a non-convertible,<sup>6</sup> preferred security (“hybrid \$1,000 depositary share”); and
3. unlisted non-convertible, preferred securities having a liquidation preference of \$1,000 or more (or a cash redemption price of \$1,000 or more) (“hybrid \$1,000 preferred security”), such as a hybrid \$1,000 preferred security that is offered directly to an investor or a preferred security underlying multiple hybrid \$1,000 depositary shares.

Any such security deemed a “TRACE-Eligible Security” would be excluded from the defined term “OTC Equity Security.”<sup>7</sup>

All other preferred securities and depositary shares representing fractional interests in these securities, except the covered hybrid securities identified above, will continue to be included in the defined term “OTC Equity Security,” and firms must report transactions in such securities to ORF.<sup>8</sup> For example, a non-convertible preferred security having a par value or liquidation preference of \$25 that is not listed on an equity facility of a national securities exchange would be an “OTC Equity Security” under the interpretation and would be required to be reported to ORF.

Thus, beginning on June 16, 2014, any firm reporting a trade in a hybrid security must report the transaction to the appropriate facility in compliance with this interpretation. However, prior to June 16, 2014, any firm requesting the set-up of a new hybrid security for trade reporting purposes may, but is not required to, do so in accordance with this interpretation.

A list of covered hybrid securities that will be moved from ORF to TRACE on June 16, 2014, is attached as Appendix A.

## Endnotes

1. See Securities Exchange Act Release No. 71927 (April 10, 2014), 79 FR 21494 (April 16, 2014) (Order Approving Proposed Rule Change, as Modified by Amendment No. 1 of File No. SR-FINRA-2013-039).
2. FINRA Rule 6710(a) defines “TRACE-Eligible Security” as a debt security that is United States (“U.S.”) dollar-denominated and issued by a U.S. or foreign private issuer, and, if a “restricted security” as defined in Securities Act Rule 144(a)(3), sold pursuant to Securities Act Rule 144A; or is a debt security that is U.S. dollar-denominated and issued or guaranteed by an Agency as defined in paragraph (k) or a Government-Sponsored Enterprise as defined in paragraph (n). However, the term “TRACE-Eligible Security” does not include a debt security that is: issued by a foreign sovereign, a U.S. Treasury Security as defined in paragraph (p), or a money market instrument as defined in paragraph (o).
3. FINRA Rule 6420(f) defines “OTC Equity Security” to include “any equity security that is not an ‘NMS stock’ as that term is defined in Rule 600(b)(47) of SEC Regulation NMS; provided, however, that the term ‘OTC Equity Security’ shall not include any Restricted Equity Security.” FINRA Rule 6420(k) defines “Restricted Equity Security” to mean “any equity security that meets the definition of ‘restricted security’ as contained in Securities Act Rule 144(a)(3).”
4. This interpretation applies solely to a hybrid security that is not listed on an equity facility of a national securities exchange. See e.g., [FINRA Trade Reporting Notice—2/22/08](#), (FINRA applied TRACE reporting requirements, distinguishing between listed and unlisted securities, and required firms to report transactions in unlisted convertible debt and unlisted equity-linked notes to TRACE, and OTC transactions in convertible debt and equity-linked notes listed on an equity facility of a national securities exchange to an appropriate FINRA equity trade reporting facility for NMS Stocks (the Alternative Display Facility (ADF) or a trade reporting facility (TRF)). For purposes of this interpretation, the term “listed on an equity facility of a national securities exchange” means a security that qualifies as an NMS stock (as defined in Rule 600(b)(47) of Regulation NMS under the Act) as distinguished from a security that is listed on a bond facility of a national securities exchange. See 17 CFR 242.600(b)(47).
5. The term “TRACE-Eligible Security” includes capital trust securities and trust preferred securities (other than a capital trust security or a trust preferred security that is listed on an equity facility of a national securities exchange) and transactions in such securities must be reported to TRACE (and not to ORF) in compliance with the applicable reporting requirements. This interpretation would apply even if the capital trust security (or a trust preferred security) was previously listed on an equity facility of a national securities exchange and reported to a FINRA equity facility, but has since been delisted. Once delisted, the security must be reported to TRACE. Similarly, any other hybrid security that does not meet the definition of “covered hybrid security” solely because it is listed on a national securities exchange would be required to be reported to TRACE once delisted.

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6. Non-convertible means not convertible into or exchangeable for property or shares of any other series or class of the issuer's capital stock.
7. This interpretation also applies to unlisted American Depositary Receipts (ADRs) on hybrid securities in the same manner in which it applies to the underlying hybrid security. Thus, an unlisted ADR on a covered hybrid security would be excluded from the definition of "OTC Equity Security" under the interpretation and would be required to be reported to TRACE. Whereas, an unlisted ADR on a depository share having a par value or liquidation preference of \$25 would be an "OTC Equity Security" under the interpretation and would be required to be reported to ORF.
8. Pursuant to Section 31 of the Act, FINRA and the national securities exchanges are required to pay transaction fees and assessments to the SEC that are designed to recover the costs related to the government's supervision and regulation of the securities markets and securities professionals. See 15 U.S.C. 78ee. FINRA obtains its Section 31 fees and assessments from its membership, in accordance with Section 3 of Schedule A to the FINRA By-Laws. The transactions that are assessable under Section 3 of Schedule A to the FINRA By-Laws are reported to FINRA through one of FINRA's equity trade reporting facilities: the ORF, the ADF, or a TRF. As expressly stated in the Act, sales of bonds, debentures, or other evidence of indebtedness (debt securities) are excluded from Section 31 of the Act. See 15 U.S.C. 78ee(b). Because of this exclusion under Section 31 of the Act, transactions reported to TRACE are not subject to the regulatory transaction fee under Section 3 of Schedule A to the FINRA By-Laws. To determine whether a non-exchange listed security is an equity security or a debt security for purposes of assessing the regulatory transaction fee, FINRA relies on the facility to which the transaction is reported. If the transaction is reported to the ORF, the transaction is treated as one involving an equity security and is subject to the regulatory transaction fee. If the transaction is reported to TRACE, the transaction is treated as one involving a debt security and thus is not subject to the regulatory transaction fee. See [\*Regulatory Notice 08-72\*](#).

## Appendix A

CUSIP/CINS	Symbol	Issuer	Issue Description
U0201H106	ALFI	ALLY FINANCIAL	7% Perp Pfd Shs Series G - Reg S
02005N605	GMSPZ	ALLY FINANCIAL, INC.	PERP PFD SER G 7%
060505DT8	BACYL	BANK OF AMERICA	Depositary Shares Representing 1/25th Fixed to Floating (Non Cumulative Preferred Series M)
060505ED2	BCXQL	BANK OF AMERICA	Depositary Share representing 1/25th Preferred Series U
064058AB6	BKNML	BANK OF NEW YORK	Depositary Shares representing 1/100th Preferred Stock Series D
06738C828	BCBAY	BARCLAYS BK ADR	ADR Series 1 Repstg Preferred Shares Series 1 (United Kingdom)
05530RAB4	BBVZF	BBVA INTERNATIONAL	Guaranteed Preferred Securities (Spain)
U1362QAA7	CPDJP	CA PFD FDG TR	Noncum Tr Pfd Secs Without Fxd Mty 2003
151327202	CRFDZ	CENTAUR FDG CORP	PREF SHS SER B 9.08% 144A
151895406	CNTQP	CENTERPOINT PFD D	Flexible Preferred Series D
172967GR6	CYGXL	CITIGROUP INC.	Depositary Shares representing 1/25th Preferred Series D
19075Q607	CBKAP	COBANK ACB/PFD SER E	Perp Preferred CL E Fixed to FLTG
239649205	DMRRP	DAYTON & MICH RR CO	Preferred Stock
30767E307	FCBTP	FARM CREDIT BANK	Perp Non Cumulative Sub Ser 1 Pfd 10% CI B
316773CM0	FTBXL	FIFTH THIRD BANCORP	Depositary Share representing 1/25th Preferred Series H
31984K209	FCCTP	FIRST COMNTY CORP A	Preferred Series A
31984K308	FCCTO	FIRST COMNTY CORP B	Preferred Series B
344437504	FONRP	FONAR CORP PFD	Preferred Stock
369622SP1	GEAPP	GENERAL ELECTRIC	Perpetual Preferred Stock Series B Fixed to Floating Rate
369622ST3	GEAPO	GENERAL ELECTRIC CAP	Perpetual Preferred Series C
43787N207	HMTAP	HOMETOWN BANKSHARES	Non cumulative Perpetual Preferred

CUSIP/CINS	Symbol	Issuer	Issue Description
48124BAC9	JPYYL	JP MORGAN	Depositary Shares Representing 1/10th Preferred Series Q
46625HHA1	JFTTL	JP MORGAN CHASE	Depositary Shares Representing 1/10th Preferred Series I
46625HJQ4	JPJQL	JP MORGAN CHASE	Depositary Shares Representing 1/10th Preferred Series S Fixed to Floating
46625HJW1	JPMQL	JP MORGAN CHASE	Depositary Shares Representing 1/10th interest fixed to floating preferred series U
48126HAA8	JPPML	JP MORGAN CHASE	Dep Shs Repstg 1/10th Pfd Ser R
49455T202	KMRFZ	KINDER MORGAN 144A	Cumulative Pfd Ser A 144A
539439AA7	LLYDZ	LLOYDS BANKING	ADR Repstg Pref Shs 144A (United Kingdom)
539439AC3	LLYBZ	LLOYDS BANKING	ADR Repstg Pref Ser A 144A (United Kingdom)
539439AE9	LLYKY	LLOYDS BANKING	Sponsored ADR Representing Preferred Shares Fixed to Floating Reg S (United Kingdom)
539439AF6	LLYKZ	LLOYDS BANKING	ADR Repstg Pref Shs Fxd Fltg 144A (United Kingdom)
G5533WAB3	LLYZF	LLOYDS BANKING	Preferred Shares American Depositary receipt Representing Preferred 100 Shares Reg (-S Fixed to Floating) (United Kingdom)
539439AB5	LYGZY	LLOYDS BANKING GRP	Ordinary Shares (ADR representing preference shares Reg S) (United Kingdom)
55261FAG9	MTBPP	M&T BANK	Perpetual Preferred Series E Fixed to Floating
724481866	PBOWO	PITNEY BOWES INC	Preferred Series F 144a
693475AK1	PNCXL	PNC FINANCIAL	Depositary Shares Representing 1/100th Perpetual Preferred Series O
693475AM7	PNCYL	PNC FINANCIAL	Depositary Shares Representing 1/100th Perpetual Preferred Series R Fixed to Floating

CUSIP/CINS	Symbol	Issuer	Issue Description
74316E202	PSNNP	PROFESSIONAL SVC PFD	Preferred Stock
780097AU5	RLSPY	ROYAL BANK SCOTLAND	Sponsored ADR Ser U Repstg Pref U Shs (United Kingdom)
780097AE1	RBSLY	ROYAL BK SCOTLAND SE	American Depositary Shares
84129X206	SCSGP	SOUTHCREST FINL GROU	Preferred
846425841	SBSAO	SPAN BROAD SER B PFD	Series B Preferred Stock
900151507	TYABF	TURKIYE IS BANKA REG	Spons Reg S GDR
949746PM7	WFCNO	WELLS FARGO	Perp Pfd Cl A Ser K Fixed/Fltg
982356206	WRGFP	WRIGHT G F STL & WIR	Preferred Stock
98389Q206	XCSTP	XCELARATOR STUDI PFD	Preferred Stock
989701BD8	ZIONP	ZIONS BANC	Perpetual Preferred Series I
989701BF3	ZIONO	ZIONS BANCORPORATION	Series J Fixed/Floating Rate Non-Cumulative Perpetual Preferred Stock