

## Trade Reporting and Compliance Engine (TRACE)

### SEC Approves Amendments to Require Firms to Identify Transactions with Non-Member Affiliates in TRACE Trade Reports

Effective Date: November 2, 2015

#### Executive Summary

The SEC approved an amendment to the TRACE rules to permit FINRA to implement a new contra-party type for use by firms in identifying transactions with non-member affiliates.<sup>1</sup> The amendment also requires firms to separately identify transactions with non-member affiliates that occur within the same day, at the same price and in the same security as a trade with another contra-party. The amendment will become effective on November 2, 2015.

The amended rule text is available in the online FINRA Manual.

Questions regarding this *Notice* should be directed to:

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#### Background and Discussion

FINRA Rule 6730 (Transaction Reporting) sets out the requirements that apply to firms when reporting transactions in TRACE-eligible securities.<sup>2</sup> Rule 6730(c) (Transaction Information To Be Reported) describes the specific items of information required to be provided to FINRA in a TRACE trade report, including the identity of the other side or “contra-party” for each transaction. FINRA publicly disseminates the contra-party type, which currently is either a “D” for “dealer” or “C” for “customer.”

#### May 2015

##### Notice Type

- ▶ Rule Amendment

##### Suggested Routing

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

##### Key Topics

- ▶ Affiliates
- ▶ Dissemination
- ▶ Fixed-Income Securities
- ▶ TRACE
- ▶ Transaction Reporting

##### Referenced Rules and Notices

- ▶ FINRA Rule 6710
- ▶ FINRA Rule 6730
- ▶ FINRA Rule 6750

## Non-member Affiliate Contra-party Type

When reporting a transaction with an affiliate, the reporting firm may identify the affiliate in a TRACE trade report in one of two ways: (1) using a designated Market Participant ID (MPID) if the affiliate is a FINRA member; or (2) entering “C” for customer if the affiliate is a non-FINRA member.<sup>3</sup> FINRA believes that more specific information on an affiliate relationship between parties to a trade is useful for audit trail and transparency purposes.<sup>4</sup> Thus, this amendment creates a new contra-party type specifically for non-member affiliates of a firm, and requires all firms to use the new contra-party type to identify “non-member affiliates” as defined in Rule 6710(ee).<sup>5</sup>

## Suppression of Same-day and Same-price Transactions

The amendment also requires firms to use a new indicator to identify certain trades that typically are not economically distinct and, as such, would not provide investors useful information for pricing, valuation or risk evaluation purposes if disseminated publicly. Specifically, FINRA is requiring firms to identify trades with non-member affiliates that occur within the same day and at the same price as a trade between the firm and another contra-party in the same security. Thus, new paragraph (d)(4)(E) of Rule 6730 requires firms to use the new “non-member affiliate – principal transaction indicator” when reporting a transaction to TRACE in which both the member and its non-member affiliate act in a principal capacity, and where such trade occurs within the same day, at the same price and in the same security as a transaction between the member and another contra-party. Where a transaction report is identified with this new indicator, FINRA will suppress dissemination of the trade pursuant to Rule 6750(b)(1).<sup>6</sup>

A firm is not required to append the indicator if it does not reasonably expect to engage in a same day, same price transaction in the same security with another contra-party as with a non-member affiliate.<sup>7</sup> If, however, a member appends the non-member affiliate – principal transaction indicator to a trade report but, ultimately, does not engage in a same day, same price transaction in the same security with another contra-party, the member must correct the prior trade report to exclude the non-member affiliate – principal transaction indicator.

To simplify compliance in identifying when a non-member party meets the definition of “non-member affiliate” under the rules, the amendment permits members to conduct a periodic assessment of affiliate relationships. Specifically, new Supplementary Material .02 of Rule 6730 provides that it would be reasonable for a member to identify its non-member affiliates on a periodic basis of no less than annually (unless the member has undergone an organizational or operational restructuring that is likely to impact its prior identification of non-member affiliate relationships).

## Endnotes

1. See Securities Exchange Act Release No. 74482 (March 11, 2015), 80 FR 13940 (March 17, 2015) (SEC Order Approving File No. SR-FINRA-2014-050).
2. Rule 6710 generally defines a “TRACE-Eligible Security” as: (1) a debt security that is 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 (2) a debt security that is U.S. dollar denominated and issued or guaranteed by an “Agency” as defined in Rule 6710(k) or a “Government-Sponsored Enterprise” as defined in Rule 6710(n).
3. Transactions between a firm and a non-member contra-party are reported and disseminated as trades with a “customer,” even where such non-member is an affiliate of the reporting firm (and may be a brokerage firm in another jurisdiction).
4. This amendment does not change the way that FINRA members report trades with affiliates that also are FINRA members. The reporting firm would continue to identify the contra-party by MPID. FINRA believes that trades between members generally are arms-length, even if the member firms are affiliated. Furthermore, it is important for audit trail and surveillance purposes to obtain the MPID of all member contra-parties in submitted trade reports.
5. Rule 6710(ee) defines “non-member affiliate” as a non-member entity that controls, is controlled by or is under common control with a member. For the purposes of this definition, “control,” along with any derivative thereof, means legal, beneficial, or equitable ownership, directly or indirectly, of 25 percent or more of the capital stock (or other ownership interest, if not a corporation) of any entity ordinarily having voting rights. The term “common control” means the same natural person or entity controls two or more entities.
6. Public transparency regarding the overall transaction will continue to be made available through dissemination of the same day, same price transaction report reflecting the trade between the firm and the other contra-party.
7. A firm is not required to correct a trade report of a transaction with its non-member affiliate solely for the purpose of appending the non-member affiliate – principal transaction indicator where the firm unexpectedly engaged in a subsequent same day, same price transaction with another contra-party in the same security.