

MEMO# 30354

October 26, 2016

SEC Approves FINRA Rule Change Relating to the Reporting of US Treasury Securities to TRACE; Regulators Hold Conference to Discuss the Evolving Structure of the US Treasury Market

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TO: FIXED-INCOME ADVISORY COMMITTEE No. 44-16
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 29-16
SEC RULES MEMBERS No. 67-16 RE: SEC APPROVES FINRA RULE CHANGE RELATING TO THE REPORTING OF US TREASURY SECURITIES TO TRACE; REGULATORS HOLD CONFERENCE TO DISCUSS THE EVOLVING STRUCTURE OF THE US TREASURY MARKET

This memorandum describes two recent events of regulatory significance for the US Treasury market. Section I describes the approval of a new rule that will require members of the Financial Industry Regulatory Authority ("FINRA") to report their transactions in most US Treasury securities to the Trade Reporting and Compliance Engine ("TRACE"). Section II briefly summarizes the priorities for US Treasury market reform that US financial regulators outlined at a conference earlier this week.

I. FINRA Reporting Rules for US Treasury Securities

The Securities and Exchange Commission ("SEC" or "Commission") recently approved FINRA's proposal to amend its TRACE rules to require reporting of most secondary market transactions in US Treasury securities.[\[1\]](#) This rule change will not, however, require public dissemination of transaction information in these securities.[\[2\]](#) FINRA has announced that most aspects of the rule change will take effect on July 10, 2017.[\[3\]](#) The major aspects of the rule amendments are summarized below. The new rules are consistent with FINRA's proposal except where noted.

A. Background

On January 19, 2016, the US Department of Treasury ("Treasury") issued a request for information ("RFI") seeking public comment on structural changes in the US Treasury market and their implications for market functioning.[\[4\]](#) One aim of the RFI was to develop

a holistic view of trading and risk management practices in the US Treasury market, particularly in light of the evolution of the market resulting from technological advances over the past two decades, including the associated growth of electronic trading.[\[5\]](#) FINRA's rule change is designed to help regulators enhance their understanding of the US Treasury market.

B. Reporting Parties and Scope of Transactions Covered

TRACE rules presently require reporting of all transactions in "TRACE-Eligible Securities" that involve a FINRA member. The adopted rules amend the definition of "TRACE-Eligible Securities" to include US Treasury securities other than savings bonds. Consequently, TRACE reporting requirements will apply to transactions of FINRA members in all marketable US Treasury securities, including Treasury bills, notes, and bonds, as well as separate principal and interest components of a US Treasury security that have been separated pursuant to the Separate Trading of Registered Interest and Principal of Securities program operated by the Treasury.[\[6\]](#)

In general, FINRA rules require all FINRA members involved in transactions in TRACE-Eligible Securities — now including US Treasury Securities — to report transactions in those securities to TRACE. Transactions that do not involve a FINRA member are not covered by TRACE rules and are not required to be reported to TRACE.[\[7\]](#)

The rules include two exemptions to the new reporting requirements, one for auction[\[8\]](#) transactions and one for repurchase and reverse repurchase transactions. FINRA believes that it is unnecessary to require reporting of auction transactions because Treasury already maintains data about the auction process, so reporting these transactions to TRACE would be duplicative and provide limited additional benefit to regulators. The exemption for auction transactions does not encompass a "when-issued" transaction, *i.e.*, a transaction in a US Treasury security that is executed before the auction for that security.[\[9\]](#)

Consequently, "when-issued" transactions are subject to the new reporting rules. The exemption for repurchase and reverse repurchase transactions codifies a long-standing FINRA interpretation that such transactions are not reportable to TRACE. The Release notes that, although repurchase and reverse repurchase transactions are structured as purchases and sales, the transfer of securities effectuated as part of these transactions is not made as the result of an investment decision but, rather, is more akin to serving as collateral pledged as part of a secured financing.[\[10\]](#)

C. Required Data Elements

FINRA rules presently require reporting to TRACE of 14 data elements for each reportable transaction.[\[11\]](#) These same data elements will be required to be reported for transactions in US Treasury securities with the following five modifications and clarifications:

- The price of a "when-issued" transaction would be reported as a yield, rather than a percentage of face or par value.[\[12\]](#)
- When reporting a transaction in US Treasury securities, a FINRA member must report the time of execution to the finest increment of time captured in the member's system, but at a minimum, in increments of seconds.[\[13\]](#)
- The report of a "when-issued" transaction must include a trade indicator so that regulators will know whether the reported price is based on a percentage of face or par value or whether the member is reporting the yield.[\[14\]](#)

- The report of a transaction executed as part of a larger trading strategy must be appended with a “.B” modifier if the transaction being reported is part of a series of transactions where at least one of the transactions involves a futures contract.[\[15\]](#)
- The report of a transaction executed as part of a larger trading strategy must be appended with an “.S” modifier if the transaction being reported is part of a series of transactions and might not be priced based on the current market.[\[16\]](#)

D. Timing of Reporting

Reportable transactions in Treasury securities generally will be required to be reported on a same-day or next-day basis, depending on the time of execution. Specifically, any reportable transaction in a US Treasury security executed on a business day at or after 12:00:00 a.m. (Eastern) through 5:00:00 p.m. (Eastern) must be reported the same day.[\[17\]](#) Transactions executed on a business day after 5:00:00 p.m. (Eastern) but before the TRACE system closes must be reported no later than the next business day.[\[18\]](#) Transactions executed on a business day at or after 6:30:00 p.m. (Eastern) through 11:59:59 p.m. (Eastern) — or on a Saturday, a Sunday, a federal or religious holiday or other day on which the TRACE system is not open — must be reported on the next business day.[\[19\]](#)

II. Conference on the Evolving Structure of the US Treasury Market

On October 24, 2016, the Federal Reserve Bank of New York hosted a conference on the evolving structure of the US Treasury market in conjunction with the Department of Treasury, the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, and the SEC. Senior officials from these agencies used the conference as an opportunity to explain their regulatory priorities for the US Treasury market. The conference also featured panels on data reporting in the US Treasury cash market, clearing and settlement practices in this market, and the likely evolution of Treasury market structure. Some of the main points raised by regulators include:

- Regulators intend to issue rules that would require public dissemination of transactions in US Treasury securities. The timing and scope of this rulemaking is not yet determined, but regulators are working actively on this issue.
- Regulators are committed to ensuring that they receive reports of all secondary market transactions in US Treasury securities. Regulators appear to prefer FINRA to be the central repository for these reports.
- The SEC and FINRA are working to close perceived regulatory gaps that have allowed US Treasury market participants to operate with less regulation than participants in other securities markets.
 - Proprietary trading firms (“PTFs”) engage in a substantial volume of Treasury transactions. SEC Chair Mary Jo White indicated that she believes these firms engage in dealing activity and should be registered as dealers. SEC staff is working on a proposal to impose registration requirements on PTFs.[\[20\]](#)
 - The SEC intends to engage in rulemaking to require platforms that facilitate trading in US Treasury securities to register as either alternative trading systems or exchanges.
 - FINRA is actively working to identify provisions of its rulebook that do not apply to transactions in US Treasury securities and is considering how to address these perceived gaps.[\[21\]](#)

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endnotes

[1] Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Relating to the Reporting of Transactions in U.S. Treasury Securities to TRACE, Securities Exchange Act Release No. 79116 (October 18, 2016), *available at* <https://www.sec.gov/rules/sro/finra/2016/34-79116.pdf> (“Release”).

[2] This position is consistent with FINRA’s proposal. ICI submitted a comment letter supporting FINRA’s proposal to require reporting, but not public dissemination, of transactions in US Treasury securities. ICI’s comment letter also noted that FINRA’s proposal would provide the official sector with only partial information about the US Treasury cash market because not all intermediaries in this market are FINRA members. Accordingly, the letter urged regulators not to advance rules that could fundamentally change US Treasury market structure without a more complete understanding of the present functioning of the market than data reported pursuant to this rule will provide. See Letter from David W. Blass, General Counsel, ICI, to Brent J. Fields, Secretary, Commission, dated August 15, 2016, *available at* <https://www.ici.org/pdf/30130.pdf>.

[3] Reporting Transactions in U.S. Treasury Securities, SEC Approves Rule Change to Require Reporting of Transactions in U.S. Treasury Securities to the Trade Reporting and Compliance Engine (TRACE), FINRA Regulatory Notice 16-39 (October 2016), *available at* http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-16-39.pdf.

[4] For a summary of the RFI, please see ICI Memorandum No. 29655 (January 20, 2016), *available at* https://www.ici.org/my_ici/memorandum/memo29655.

[5] ICI submitted a comment letter in response to the RFI. See Comment Letter from David W. Blass, General Counsel, ICI, to Office of the Under Secretary for Domestic Finance, Treasury, dated April 8, 2016, *available at* <https://www.ici.org/pdf/29819.pdf>. See also ICI Memorandum No. 29819 (April 8, 2016), *available at* https://www.ici.org/my_ici/memorandum/memo29819 (summarizing the comment letter).

[6] See Release at 5.

[7] Any FINRA member that is a party to a transaction in a “TRACE-Eligible Security” must report that transaction to TRACE. This means that a reportable transaction in US Treasury securities between two FINRA members must be reported by both members. FINRA believes that two-sided reporting helps ensure accuracy because it allows FINRA to compare information reported by each party to identify discrepancies or potential non-reporting by one party, thereby enhancing the quality of the audit trail. See Release at 25-26. If a transaction involves one FINRA member and a non-member, the FINRA member must report the trade.

[8] New rule 6710(gg) defines an “auction” as “the bidding process by which the U.S. Department of the Treasury sells marketable securities to the public pursuant to Part 356 of Title 31 of the Code of Federal Regulations.”

[\[9\]](#) See Release at 6.

[\[10\]](#) See Release at 7.

[\[11\]](#) See Release at 9 (citing FINRA Rule 6730(c)). Those data elements are: (1) CUSIP number or, if a CUSIP number is not available at the time of execution, a similar numeric identifier or a FINRA symbol; (2) The size (volume) of the transaction, as required by FINRA Rule 6730(d)(2); (3) Price of the transaction (or the elements necessary to calculate price, which are contract amount and accrued interest) as required by FINRA Rule 6730(d)(1); (4) A symbol indicating whether the transaction is a buy or a sell; (5) Date of trade execution (for “as/of” trades only); (6) Contra-party’s identifier (MPID, customer, or a non-member affiliate, as applicable); (7) Capacity — principal or agent (with riskless principal reported as principal); (8) Time of execution; (9) Reporting side executing broker as “give-up” (if any); (10) Contra side introducing broker in case of “give-up” trade; (11) The commission (total dollar amount); (12) Date of settlement; (13) If the member is reporting a transaction that occurred on an ATS pursuant to FINRA Rule 6732, the ATS’s separate MPID obtained in compliance with FINRA Rule 6720(c); and (14) Such trade modifiers as required by either the TRACE rules or the TRACE users’ guide.

[\[12\]](#) The yield reported by a FINRA member for a “when-issued” transaction conducted on a principal basis must include any mark-up or mark-down. If the member acts in an agency capacity, the total dollar amount of any commission must be reported separately. See Release at 9.

[\[13\]](#) See Release at 10.

[\[14\]](#) See Release at 10.

[\[15\]](#) See Release at 10-11.

[\[16\]](#) See Release at 11. This requirement differs from what FINRA initially proposed. As proposed, this rule would have required the use of the “.S” modifier “if the transaction is part of a series of transactions where at least one of the transactions is executed at a pre-determined fixed price *or would otherwise result in the transaction being executed away from the current market.*” (emphasis supplied). The final rule requires the use of this modifier if the transaction “is part of a series of transactions *and may not be priced based on the current market.*” (emphasis supplied). FINRA believes this change will reduce compliance burdens because a member would not be required to assess whether a particular transaction was, in fact, priced away from the market at the time of execution when attaching the “.S” modifier. See Release at 11, n. 40.

The two trade modifiers are not subject to the July 10 implementation date. FINRA believes it may take firms more time to establish and implement a process for appending trade modifiers and therefore will announce the implementation date for the trade modifiers at a later time.

[\[17\]](#) See Release at 8.

[\[18\]](#) These transactions must be designated “as/of” and include the date of execution if they are reported on the following business day. See Release at 8, n. 27.

[\[19\]](#) These transactions must be designated “as/of” and include the date of execution. See Release at 8, n. 27.

[20] Chair White indicated that registration requirements for PTFs could apply to PTFs in the US Treasury market and the equities markets.

[21] FINRA recently submitted a letter to the SEC explaining the application of its rules to US Treasury securities. See Letter from Robert W. Cook, President and Chief Executive Officer, FINRA, to Stephen Luparello, Director, Division of Trading and Markets, SEC, dated October 17, 2016, *available at*

<http://www.finra.org/sites/default/files/FINRA-Comment-Letter-SEC-10-17-16.pdf>.

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