

**MEMO# 23316**

March 30, 2009

# **FINRA Proposes to Expand Scope of Securities Subject to TRACE Reporting**

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TO: SEC RULES MEMBERS No. 35-09  
FIXED-INCOME ADVISORY COMMITTEE No. 10-09 RE: FINRA PROPOSES TO EXPAND  
SCOPE OF SECURITIES SUBJECT TO TRACE REPORTING

The Financial Industry Regulatory Authority (“FINRA”) has filed two proposed rule changes with the U.S. Securities and Exchange Commission (“SEC”) to amend the definition of TRACE-eligible security. [\[1\]](#) According to FINRA, the proposals are designed to improve transparency, enhance investor protection, and foster market integrity across a larger portion of the debt market.

## **Proposal to Include Securities Eligible for Public Sale and Securities that are Restricted Securities**

The first proposal would expand the definition of TRACE-eligible security by eliminating the existing requirement that such securities (1) be registered under the Securities Act of 1933 or (2) issued pursuant to Section 4(2) of the Securities Act and purchased or sold pursuant to Securities Act Rule 144A. [\[2\]](#) By eliminating these restrictions, the proposed rule change would broaden the range of corporate debt securities subject to TRACE reporting and transparency requirements.

## **Proposal to Include Agency Debt Securities and Primary Market Transactions**

The second proposal would amend the definition of TRACE-eligible securities to include transaction reporting in debt securities issued or guaranteed by an Agency [\[3\]](#) or a

government-sponsored enterprise (“GSE”) and primary market transactions. [\[4\]](#) FINRA explains in its proposal that the expansion of the definition of TRACE-eligible securities to include Agency debt securities should provide additional transparency and foster the development of improvements observed in corporate bonds across a broader portion of the debt market. In addition, it states that adding primary market transactions to TRACE should enhance market surveillance.

### Agency Debt Securities

The current definition of TRACE-eligible security expressly excludes securities that are issued by a GSE, or are asset-backed securities, mortgage-backed securities, collateralized mortgage obligations, or money market instruments that at issuance have a maturity of one year or less. FINRA would expand the definition to include Agency debt securities. Specifically, an “Agency debt security” would be defined as a debt security issued or guaranteed by an Agency or issued or guaranteed by a GSE. [\[5\]](#) The term would exclude securities issued by the U.S. Treasury or asset-backed securities issued or guaranteed by an Agency or GSE.

According to the proposal, members would be required to report transactions in Agency debt securities within 15 minutes of execution of the transactions (i.e., the current reporting requirement), subject to the standard exceptions currently set forth in the TRACE rules. Information would be disseminated by FINRA immediately upon receipt of transaction reports, subject to one exception for Securities Act Rule 144A transactions. FINRA would use its current protocols that determine how volume information is disseminated. [\[6\]](#) However, the proposal would amend the term “Investment Grade” [\[7\]](#) to treat unrated Agency debt securities as Investment Grade securities for purposes of the dissemination protocols.

### Primary Market Transactions

The proposal would require members to report all primary market transactions and designate such transactions with an identifier to distinguish them from secondary market transactions. [\[8\]](#) Members would be required to report primary market transactions, except those that are defined as “List or fixed offering price transactions” [\[9\]](#) and “Takedown transactions” [\[10\]](#) within 15 minutes of the time of execution. The information would be disseminated immediately upon receipt of the transaction reports.

The proposal would have more flexible reporting requirements for “List or fixed offering price transactions” and “Takedown transactions.” In particular, they would be subject to end-of-day reporting requirements, would not be disseminated, and would not be subject to reporting fees, if timely and accurately reported.

### Market Data Fees

FINRA also proposes to adjust its market data fees to reflect the expanded scope of TRACE-eligible securities. Specifically, it would distinguish TRACE transactions data sets as one comprised solely of corporate bond transaction information and a second comprised solely of Agency debt securities transaction information. The fee schedule applicable to the newly TRACE-eligible securities would reflect the current schedule. However, members would not be charged a reporting fee when reporting a List or fixed offering price transaction or a Takedown transaction on a timely and accurate basis.

## Technical Amendments

The proposal would implement several other technical changes to the TRACE reporting regime. Among those, it would eliminate the current criteria that TRACE-eligible securities be depository eligible because FINRA's current systems can capture information on the few securities that are not assigned CUSIPs but otherwise meet TRACE eligibility standards.

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## endnotes

[1] The Trade Reporting and Compliance Engine ("TRACE") is the FINRA system that facilitates dissemination of price and other transaction information on certain debt securities, including statistics such as most active bonds, volume, advances, declines and new highs and lows.

[2] See SEC Release No. 59519 (March 5, 2009), 74 FR 10630 (March 11, 2009). The proposal may be found on the SEC's website at:  
<http://www.sec.gov/rules/sro/finra/2009/34-59519.pdf>.

[3] "Agency" would mean a U.S. "executive agency" that is authorized to issue debt directly or through a related entity, such as a government corporation, or to guarantee the repaying of principal and/or interest of a debt security issued by another – e.g., the Commodity Credit Corporation and the Export-Import Bank of the United States. ("Executive Agency" would mean an Executive department, Government corporation, or an independent establishment.)

[4] See Proposed Rule Change Relating to Expansion of TRACE to Include Agency Debt Securities and Primary Market Transactions, FINRA File No. 2009-10, March 18, 2009. The proposal has not been published by the SEC yet but may be found on FINRA's website at:  
<http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p118087.pdf>.

[5] Securities issued by GSEs would be included as "Agency debt securities" for purposes of the TRACE rules despite the fact that technically GSEs are instrumentalities of the U.S. government, and not Agencies.

[6] Under the protocols: (1) for Investment Grade transactions in sizes less than or equal to \$5 million, actual volume will be disseminated; and in sizes exceeding \$5 million, a "\$5 million+" capped volume indicator will be disseminated; and (2) for Non-Investment Grade

transactions in sizes less than or equal to \$1 million, actual volume will be disseminated; and in sizes exceeding \$1 million, a "\$1million+" capped volume indicator will be disseminated.

[7] "Investment Grade" currently is defined as a TRACE-eligible security that, if rated by only one nationally recognized statistical rating organization ("NRSRO"), is rated in one of the four highest generic rating categories; or if rated by more than one NRSRO, is rated in one of the four highest generic rating categories by all or a majority of such NRSROs; provided that if the NRSROs assign ratings that are evenly divided between (i) the four highest generic ratings and (ii) ratings lower than the four highest generic ratings, FINRA will classify the TRACE-eligible security as Non-Investment Grade for purposes of TRACE. If a TRACE-eligible security is unrated, for purposes of TRACE, FINRA may otherwise classify the TRACE-eligible security as an Investment Grade security and further classify it as being in one of the four highest generic rating categories.

[8] Members would be required to use one of three identifiers: primary market, secondary market, or "List or fixed offering price transactions" and "Takedown transactions" (as discussed below).

[9] "List or fixed offering price transactions" are executed at a previously fixed price from a broker-dealer acting as an underwriter to a purchaser. For purposes of the TRACE rules, such transactions must occur on the first day of the offering.

[10] "Takedown transactions" are certain sale transactions among certain market professionals involved in the placement of the offered securities. For purposes of the TRACE rules, such transactions must occur on the first day of the offering.