

MEMO# 30068

July 21, 2016

FINRA Proposes Rule Change Relating to the Reporting of U.S. Treasury Securities to TRACE; Member Call Scheduled for July 27 at 2:00 p.m. (Eastern)

[30068]

July 21, 2016

TO: FIXED-INCOME ADVISORY COMMITTEE No. 19-16
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 16-16
SEC RULES COMMITTEE No. 32-16 RE: FINRA PROPOSES RULE CHANGE RELATING TO THE REPORTING OF U.S. TREASURY SECURITIES TO TRACE; MEMBER CALL SCHEDULED FOR JULY 27 AT 2:00 P.M. (EASTERN)

The Financial Industry Regulatory Authority (“FINRA”) recently proposed a rule change that would expand its Trade Reporting and Compliance Engine (“TRACE”) reporting rules to include most secondary market transactions in U.S. Treasury securities. [1] The proposed rule change would not, however, require public dissemination of transaction information in these securities. This memorandum summarizes the key elements of the proposal. The comment period on the proposed rules will close 21 days after publication of the proposal in the Federal Register, which is expected soon. After the comment period, the Securities and Exchange Commission (“SEC”) will determine whether to approve the proposed rule change.

We will hold a 60-minute member call to discuss the proposal on July 27 at 2:00 p.m. (Eastern). If you wish to participate on that call, please send an email to Jennifer Odom at jodom@ici.org to receive dial-in information.

Background

On January 19, 2016, the U.S. Department of Treasury (“Treasury”) issued a request for information (“RFI”) seeking public comment on structural changes in the U.S. Treasury market and their implications for market functioning. [2] One aim of the RFI was to develop a holistic view of trading and risk management practices in the U.S. 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. [3] The proposed rule change is FINRA's proposal to require reporting by its members of transactions in U.S. Treasury securities.

Reporting Parties and Scope of Transactions Covered

The proposed rule change would require all FINRA members involved in transactions in U.S. Treasury securities, as defined in the TRACE rules, to report most transactions in those securities to TRACE. Transactions that do not involve a FINRA member would not be subject to the proposal and, therefore, would not be reported to TRACE. [4]

Currently, TRACE rules apply reporting requirements to transactions involving "TRACE-Eligible Securities," a category that excludes U.S. Treasury securities. FINRA proposes to amend the definition of "TRACE-Eligible Security" to include U.S. Treasury securities other than savings bonds, thereby extending TRACE reporting requirements to these securities. [5]

The proposed rule change would provide two exceptions to the new reporting requirements, one for auction [6] 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. FINRA notes that the exception for auction transactions does not encompass a "when-issued" transaction, i.e., a transaction in a U.S. Treasury security that is executed before the auction for that security. [7] Consequently, "when-issued" transactions would be subject to the new reporting rule. The exemption for repurchase and reverse repurchase transactions codifies a long-standing FINRA interpretation that such transactions are not reportable to TRACE. FINRA 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. [8]

Required Data Elements

FINRA rules presently require reporting to TRACE of 13 data elements for each reportable transaction. [9] The proposal generally would require the reporting of these same data elements for transactions in U.S. 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. [10]
- The proposed rule change would require reporting of a more precise time of execution for Treasury transactions that are executed electronically. When reporting such transactions, a FINRA member would be required to 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. [11]
- 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. [12]
- 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. [13]

- 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 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. [14]

Timing of Reporting

The proposed rule change generally would require reportable transactions in Treasury securities to be reported on the same day as the transaction on an end-of-day basis. Specifically, any reportable transaction in a U.S. Treasury security executed on a business day at or after 12:00:00 a.m. (Eastern) through 5:00:00 p.m. (Eastern) would be required to be reported the same day. [15] 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. [16] 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. [17]

Effective Date

If the SEC approves the proposed rule change, FINRA intends to announce the effective date of the rule change in a Regulatory Notice to be published no later than 90 days following SEC approval. The effective date will be no later than 365 days following SEC approval. [18]

George M. Gilbert
Counsel

endnotes

[1] Notice of Filing of a Proposed Rule Change Relating to the Reporting of U.S. Treasury Securities to the Trade Reporting and Compliance Engine, Securities Exchange Act Release No. 78359 (July 19, 2016), available at <https://www.sec.gov/rules/sro/finra/2016/34-78359.pdf> (“Release”). The proposed rule text associated with the Release is available at <https://www.sec.gov/rules/sro/finra/2016/34-78359-ex5.pdf>.

[2] See ICI Memorandum No. 29655 (January 20, 2016), available at https://www.ici.org/my_ici/memorandum/memo29655.

[3] 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).

[4] FINRA notes that, as is currently with case with all TRACE reporting obligations, any 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 U.S. Treasury securities between two FINRA members must be reported by both members. See Release at 7. If a transaction involves one FINRA member and a non-member, the FINRA member would be

required to report the trade.

[5] Specifically, the proposal would include all marketable U.S. Treasury securities, including Treasury bills, notes, and bonds, as well as separate principal and interest components of a U.S. Treasury security that have been separated pursuant to the Separate Trading of Registered Interest and Principal of Securities program operated by the Treasury. See Release at 6.

[6] The proposal would define 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.” See Release at 8, n. 20.

[7] See Release at 8.

[8] See Release at 8-9.

[9] See Release at 10 (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; and (13) Such trade modifiers as required by either the TRACE rules of the TRACE users guide.

[10] As is the case whenever price is reported for a transaction executed on a principal basis, the yield reported by a FINRA member for a “when-issued” transaction must include any mark-up or mark-down. If the member, however, acts in an agency capacity, the total dollar amount of any commission must be reported separately. See Release at 11.

[11] See Release at 11-12.

[12] See Release at 12.

[13] See Release at 12-13.

[14] See Release at 13.

[15] See Release at 9.

[16] 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 9-10.

[17] These transactions must be designated “as/of” and include the date of execution. See Release at 10.

[18] See Release at 14.

Source URL: <https://icinew-stage.ici.org/memo-30068>

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.