FINRA Proposes Reporting Requirements for Treasury Securities

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On July 18, 2016, FINRA filed with the Securities and Exchange Commission a proposal that would expand the Trade Reporting and Compliance Engine ("**TRACE**") reporting rules to require FINRA members to report most transactions in marketable debt securities issued by the Treasury Department ("**Treasuries**"), which include Treasury bills, notes and bonds.

The proposal is part of a regulatory effort to gather better data on the market for Treasuries following an unexplained and unusually high level of volatility in that market in October 2014. Specifically, it is FINRA's response to a request by the Treasury Department and the SEC to consider requiring its members to report Treasuries to a centralized depository to facilitate the collection and monitoring of Treasuries trading by and through FINRA member broker-dealers. Significantly, at this stage, FINRA would collect the information for regulatory purposes only, and it is not proposing to publicly disseminate reported trades.

Key Aspects of the Proposal

FINRA currently requires members to report transactions in specified types of debt securities to FINRA through TRACE. Subject to limited exceptions, transaction information reported to TRACE is disseminated to the public, providing transparency into recent transaction pricing. Treasuries are currently excluded from TRACE reporting requirements. The proposal would remove this exclusion, and require FINRA members to report via TRACE most Treasuries transactions that they effect. Highlights of the proposal include:

- **Trade Reporting Time Frame.** FINRA members would need to report transactions involving Treasuries on the same day as the transaction on an end-of-day basis (subject to exceptions), rather than the more immediate reporting requirement of 15 minutes that currently applies to most transactions reported to TRACE. Trades effected after hours and on weekends or holidays would be subject to reporting on the next business day. The trade elements to be reported are listed in the sidebar on the following page.
- **When-Issued Transactions.** While the proposal would exempt from TRACE reporting purchases from the Treasury Department as part of an auction, the proposal would require reporting of "when-issued transactions," i.e., transactions in a Treasury executed before the auction for the security.
- **Special Modifiers.** The proposal would require the use of two modifiers to indicate particular transactions that are part of larger trading strategies: (1) a ".B" modifier would be added to a trade report if the transaction being reported is part of a series of transactions where at least one of the transactions involves a futures contract (*e.g.*, a basis trade), and (2) an ".S" modifier would be added 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.
- **Exempted Transactions.** The proposal would exempt from reporting: (1) repurchase and reverse repurchase transactions in Treasuries (consistent with FINRA's existing interpretation of TRACE requirements); (2) auction transactions that are purchased as part of a bidding process

by which the Treasury Department sells marketable securities to the public; and (3) transactions in savings bonds and Treasury futures.

- **STRIPS.** The proposal would require reporting of trades involving separate principal and interest components of a Treasury that has been separated pursuant to the Separate Trading of Registered Interest and Principal of Securities ("**STRIPS**") program operated by the Treasury Department. However, the act of separating or reconstituting the Treasury components under the STRIPS program would not be reportable.
- **No Transaction-Level Fees.** FINRA members would not initially be subject to transaction-level fees in connection with reporting transactions in Treasuries. This is subject to change, however, once FINRA has more data relating to the size and volume of reporting in Treasuries.

FINRA members would be required to report the following elements concerning a reportable trade:

- CUSIP number (or similar numeric identifier or symbol);
- the transaction's size/volume;
- the transaction's price (or elements necessary to calculate price) or, for Treasuries executed before the security "auction," the yield;
- a symbol indicating buy or sell;
- the date of trade execution, if applicable;
- the contra-party's identifier;
- capacity as either principal or agent;
- time of execution;
- reporting side executing broker as "give-up," if any;
- contra side introducing broker in case of "give-up" trade;
- the commission, if applicable;
- the settlement date;
- the ATS identifier, if applicable; and
- applicable trade modifiers.

Timing and Implementation

SEC approval is required for the rule change to become effective. If and when the proposal is approved, FINRA will issue a Regulatory Notice within 90 days announcing the rule's effective date, which will be within 365 days of the SEC's approval.

The comment period for the proposal runs until August 15, 2016.

Policy and Practical Considerations

As FINRA acknowledges, because TRACE reporting only applies to FINRA member broker-dealers, the proposal, if approved, will only capture a limited segment of Treasury market activity and will therefore only yield a limited view of the market. In order to achieve the regulatory objective of understanding and potentially preventing future dislocations in the market (and in the integrally-related Treasury futures market), a broader initiative by multiple regulators would be required.

FINRA members will need to expend considerable efforts to extend their TRACE reporting infrastructures, and related policies, procedures and compliance oversight, in order to implement the proposed reporting requirements. Industry participants are likely to question whether the compliance burden is justified in order to achieve the partial visibility that FINRA's collection of data will provide. While the Treasury Department has indicated that it intends to work with other regulators to collect similar data from market participants other than broker-dealers, FINRA members may question whether the benefits of a FINRA data collection exercise that could be supplanted in the future by a larger (and potentially inconsistent) multi-regulator exercise would outweigh the costs — particularly if there is the potential that FINRA members' affiliated banks, investment managers and CFTC-regulated entities may be subject to different reporting requirements on different timetables.

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