

# Regulatory Notice

16-39

## 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)

Reporting Implementation Date: July 10, 2017

#### Executive Summary

Beginning July 10, 2017, FINRA member firms must begin reporting transactions in U.S. Treasury Securities to FINRA via TRACE. This *Notice* describes the scope of the term “U.S. Treasury securities” for purposes of the new reporting requirement; the specific transactions in U.S. Treasury securities that are reportable and those that are exempt from the reporting requirement; and the information that must be reported to TRACE when reporting transactions in U.S. Treasury securities, including a new trade indicator and two new modifiers. FINRA is publishing technical specifications concurrently with this *Notice*, which are available on [FINRA’s website](#). At this time, FINRA will not disseminate information on transactions in U.S. Treasury securities and will not charge transaction-level fees on transactions in U.S. Treasury securities reported to TRACE.

The new rule text is available in the online FINRA Manual on FINRA’s website.

Questions concerning this *Notice* should be directed to:

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- ▶ Patrick Geraghty, Vice President, Market Regulation, at (240) 386-4973; or
- ▶ Brant Brown, Associate General Counsel, Office of General Counsel, at (202) 728-6927.

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#### Notice Type

- ▶ New Rule

#### Suggested Routing

- ▶ Compliance
- ▶ Government Securities
- ▶ Institutional
- ▶ Internal Audit
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Senior Management
- ▶ Systems
- ▶ Trading
- ▶ Training

#### Key Topics

- ▶ Fixed Income
- ▶ TRACE
- ▶ Trade Reporting
- ▶ U.S. Treasury Securities

#### Referenced Rules & Notices

- ▶ Regulatory Notice 14-21
- ▶ FINRA Rule 6380A
- ▶ FINRA Rule 6380B
- ▶ FINRA Rule 6622
- ▶ FINRA Rule 6710
- ▶ FINRA Rule 6730
- ▶ FINRA Rule 7730
- ▶ Schedule A to the FINRA By-Laws

## Background & Discussion

### Background

The market in debt securities issued by the U.S. Department of the Treasury (Treasury Department), or “Treasuries,” is the deepest and most liquid government securities market in the world. Treasuries—such as bills, notes and bonds—are debt obligations of the U.S. government, and because these debt obligations are backed by the “full faith and credit” of the government, and thus by its ability to raise tax revenues and print currency, Treasuries are generally considered the safest of all U.S. investments. Treasuries are traded by broker-dealers that are FINRA members as well as commercial bank dealers and principal trading firms that are not registered as broker-dealers with the SEC or members of FINRA; however, there is not currently a complete public repository or audit trail for information on transactions in Treasuries.

In response to unexplained volatility in the U.S. Treasury market in October 2014, an interagency working group (IAWG) led by the Treasury Department issued a detailed joint staff report (JSR) on July 13, 2015, that included a set of preliminary findings on the volatility, described the current state of the U.S. Treasury market, and proposed a series of four “next steps” in understanding the evolution of the U.S. Treasury market.<sup>1</sup> Included among these “next steps” was an assessment of the data available to regulators and to the public regarding the cash market for Treasuries.

Following publication of the JSR, on January 19, 2016, the Treasury Department published a Request for Information (RFI) seeking public comment on structural changes in the U.S. Treasury market and their implications for market functioning.<sup>2</sup> The RFI included four sections, each of which expanded upon one of the four “next steps” identified in the JSR, and each section included numerous questions for public consideration and comment. Included within the RFI were numerous questions requesting comment on official sector access to data regarding the cash market for Treasuries and whether dissemination of U.S. Treasury market transaction data to the public would be beneficial.

Following receipt and review of the comment letters, the Treasury Department and the SEC announced that “they are working together to explore efficient and effective means of collecting U.S. Treasury cash market transaction information,” and as part of this effort, they requested that FINRA “consider a proposal to require its member brokers and dealers to report Treasury cash market transactions to a centralized repository.”<sup>3</sup> The Treasury Department noted that it “will continue working with other agencies and authorities to develop a plan for collecting similar data from institutions who actively trade U.S. Treasury securities but are not FINRA members.”<sup>4</sup>

In response to this request, on July 18, 2016, FINRA filed a proposed rule change to adopt new reporting requirements for transactions in U.S. Treasury securities, as defined in the TRACE Rules.<sup>5</sup> The SEC approved the new requirements, which are described below, on October 18, 2016.<sup>6</sup> Beginning July 10, 2017, FINRA member firms must begin reporting transactions in U.S. Treasury securities to FINRA. Firms are not required to include the two new modifiers, as applicable, in their TRACE reports for transactions in U.S. Treasury securities beginning July 10, 2017. FINRA will announce the implementation date for the new modifiers at a later date. At this time, FINRA will not disseminate information on these transactions, and FINRA will not charge fees on transactions in U.S. Treasury securities reported to TRACE.

### Discussion

Below, the *Notice* describes:

- ▶ the scope of the term “U.S. Treasury securities” for purposes of the TRACE reporting requirement;
- ▶ the transactions in U.S. Treasury securities that are reportable and those that are exempt from the reporting requirement;
- ▶ the information that must be reported to TRACE when reporting transactions in U.S. Treasury securities, including a new trade indicator and two new modifiers; and
- ▶ the implementation schedule.

In addition to this *Notice*, FINRA is also publishing technical specifications describing the new reporting requirements for U.S. Treasury securities, which are available on [FINRA’s website](#).

### Scope of Securities

The TRACE Rules require the reporting of transactions in all “TRACE-eligible securities.” Under the amendments, the term “TRACE-eligible securities” now includes “U.S. Treasury securities,” which includes all securities issued by the Treasury Department with the exception of savings bonds.<sup>7</sup> Consequently, the TRACE reporting requirements will apply to all marketable Treasuries, including Treasury bills,<sup>8</sup> notes, bonds, and inflation-protected securities (often called “TIPS”).<sup>9</sup> The new reporting requirement also applies to 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 (STRIPS) program operated by the Treasury Department.<sup>10</sup>

### Reportable Transactions

In general, any transaction in a TRACE-eligible security is a “reportable TRACE transaction” unless the transaction is subject to an exemption.<sup>11</sup> Rule 6730(e) provides several exemptions from the TRACE trade reporting requirements for certain types of transactions. The amendments add an exemption to Rule 6730(e) for purchases of a U.S. Treasury security from the Treasury Department as part of an auction.<sup>12</sup> When-issued transactions, which can take place after the Treasury Department’s announcement of an auction but before the auction and issuance of the securities, are reportable under the new reporting requirements.

As amended, Rule 6730(e) exempts an “auction transaction,” defined as the purchase of a U.S. Treasury security in an auction, from the TRACE reporting requirements. A when-issued transaction in a U.S. Treasury security must be reported to TRACE with an appropriate trade indicator, as described below. For transaction reporting purposes, reopening transactions in a U.S. Treasury security that is the subject of an auction would also be treated as “when-issued transactions.”

The amendments also codify the long-standing interpretation for all TRACE-eligible securities that repurchase and reverse repurchase transactions are not reportable to TRACE.<sup>13</sup> Thus, these types of transactions, including those involving U.S. Treasury securities, are not required to be reported to TRACE.

As is currently the case with all TRACE reporting obligations, any FINRA member firm that is a “Party to a Transaction” in a TRACE-eligible security is required to report the transaction; thus, a reportable TRACE transaction in U.S. Treasury securities between two FINRA member firms must be reported by both firms.<sup>14</sup> The amendments require reportable TRACE transactions in U.S. Treasury securities generally to be reported on the same day as the transaction on an end-of-day basis. Under the amendments to Rule 6730(a), reportable TRACE transactions in U.S. Treasury securities executed on a business day at or after 12:00:00 a.m. Eastern Time through 5:00:00 p.m. Eastern Time must be reported the same day during TRACE system hours.<sup>15</sup> Transactions executed on a business day after 5:00:00 p.m. Eastern Time but before the TRACE system closes must be reported no later than the next business day (T + 1) during TRACE system hours, and, if reported on T + 1, designated “as/of” and include the date of execution. Transactions executed on a business day at or after 6:30:00 p.m. Eastern Time through 11:59:59 p.m. Eastern Time—or on a Saturday, a Sunday, a federal or religious holiday or other day on which the TRACE system is not open at any time during that day (determined using Eastern Time)—must be reported the next business day (T + 1) during TRACE system hours, designated “as/of,” and include the date of execution. Firms that wish to report transactions in U.S. Treasury securities on an immediate basis may do so; however, those firms that may find it more cost effective or beneficial to report on an end-of-day basis may report pursuant to the timeframes established in Rule 6730.

**Reportable Transaction Information**

Rule 6730(c) lists the following transaction information that must be reported to TRACE for each reportable TRACE transaction:

- (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 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 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 [Rule 6732](#), the ATS’s separate MPID obtained in compliance with [Rule 6720\(c\)](#); and
- (14) Such trade modifiers as required by either the TRACE rules or the TRACE users guide.

The amendments apply these same information requirements to TRACE trade reports in U.S. Treasury securities; however, the amendments clarify how some of this information must be reported when the transaction involves a U.S. Treasury security. First, the amendments clarify that, because when-issued trading is based on yield rather than on price as a percentage of face or par value, the yield should be reported in lieu of the price when the transaction is a when-issued transaction, as defined in the TRACE Rules. The amendments also make clear that, as is the case whenever price is reported for a transaction executed on a principal basis, the yield reported for a when-issued transaction must include any mark-up or mark-down. If the firm is acting in an agency capacity, the total dollar amount of any commission must be reported separately.

Second, the amendments require reporting of a more precise time of execution for transactions in U.S. Treasury securities that are executed electronically. New Supplementary Material .04 to Rule 6730 requires that, when reporting transactions in U.S. Treasury securities executed electronically, firms report the time of execution to the finest increment of time captured in the firm's system (*e.g.*, milliseconds or microseconds) but, at a minimum, in increments of seconds. Importantly, the amendments do not require firms to update their systems to comply with a finer time increment; rather, the Supplementary Material simply requires a firm to report the time of execution to TRACE in the same time increment its system already captures.<sup>16</sup>

Finally, the amendments adopt a new trade indicator and two new trade modifiers that reflect unique attributes of the U.S. Treasury cash market. As amended, Rule 6730 includes a new trade indicator for any reportable TRACE transaction in a U.S. Treasury security that meets the definition of "when-issued transaction." This indicator will permit FINRA to determine whether price is being reported on the transaction based on a percentage of face or par value or whether, as required for when-issued transactions, the firm is reporting the yield, and the indicator can be used to validate transactions in a U.S. Treasury security that are reported with an execution before the auction and issuance of the security have taken place.

In addition to the new indicator, the amendments to Rule 6730 require the use of two new modifiers, when applicable, to reported transactions in U.S. Treasury securities. Individual transactions in U.S. Treasury securities are often executed as part of larger trading strategies, which can result in individual transactions reported to TRACE being priced away from the current market for legitimate reasons. The amendments include two new modifiers to indicate particular transactions that are part of larger trading strategies and therefore may be executed at prices away from the market at the time of the transaction. The amendments to Rule 6730 require that firms append the following modifiers, as applicable, to trade reports for U.S. Treasury securities:

- ▶ 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 (*e.g.*, a "basis" trade); and
- ▶ an ".S" modifier if the transaction being reported is part of a series of transactions and may not be priced based on the current market (*e.g.*, a fixed price transaction in an "on-the-run" security as part of a transaction in an "off-the-run" security).

The ".S" modifier applies more broadly than the ".B" modifier in that it applies to a trade report if the transaction being reported is part of a series of transactions that could result in the reported transaction being executed away from the current market. The ".S" modifier applies to a transaction in a particular strategy that meets the ".S" criteria regardless of whether it is, in fact, off market and is therefore permitted when a transaction is part of a series and could be, but need not be, priced away from the market.

As noted above, because FINRA believes it may take firms more time to establish and implement a process for appending trade modifiers, the implementation date for the requirement to attach “.B” or “.S” trade modifiers, if applicable, will be announced at a later date. FINRA notes, however, that firms will be permitted to append the modifiers beginning July 10, 2017, which may help reduce potential “false positive” alerts for transactions executed at prices away from the market at the time of the transaction.

## **Implementation**

### *Implementation Dates*

The requirement to report transactions in U.S. Treasury securities to TRACE is being implemented in two separate phases. First, FINRA member firms must begin reporting transactions in U.S. Treasury securities on July 10, 2017. The use of the new “.B” and “.S” trade modifiers—the second phase—will not be required beginning on July 10, 2017, and FINRA will announce the implementation date at a later time. Firms are permitted to append the trade modifiers beginning on July 10, 2017.

### *Fees*

At this time, FINRA is not charging TRACE transaction-level fees on reports for U.S. Treasury securities, and FINRA has exempted these transactions from the Trading Activity Fee.<sup>17</sup> As in other FINRA trade reporting system contexts, re-reporting and amending of trades are captured in a firm’s error statistics published on the TRACE Report Cards even if the transactions are not considered late. However, as no transaction reporting fees are being charged for U.S. Treasury security reporting at this time, there will be no fees charged for re-reports or amendments.

### *CUSIP Registration*

FINRA intends to register the CUSIPs for outstanding U.S. Treasury securities with TRACE so firms will not be required to do so, and CUSIPs for these securities will be included on FINRA’s daily list of reportable securities. On a going-forward basis, FINRA will register CUSIPs in U.S. Treasury securities for TRACE reporting purposes coincident with the announcement by the Treasury Department of an auction.<sup>18</sup>

## Endnotes

1. See [\*Joint Staff Report: The U.S. Treasury Market on October 15, 2014\*](#), at 7 (July 13, 2015). The IAWG consists of representatives of the Treasury Department, the Federal Reserve Board of Governors, the Federal Reserve Bank of New York, the SEC and the CFTC.
2. The RFI, which was written in consultation with the staffs of all of the agencies involved in the JSR, was published in the *Federal Register* on January 22, 2016. See Notice Seeking Public Comment on the Evolution of the Treasury Market Structure, 81 FR 3928 (January 22, 2016).
3. Press release, [U.S. Department of the Treasury, Statement on Trade Reporting in the U.S. Treasury Market](#) (May 16, 2016). See also press release, [U.S. Securities and Exchange Commission, Statement on Trade Reporting in the U.S. Treasury Market](#) (May 16, 2016).
4. In August, the agencies in the IAWG announced that they “will continue to assess effective means to ensure that the collection of data regarding Treasury cash securities market transactions is comprehensive and includes information from institutions are that not FINRA members.” See press release, [U.S. Department of the Treasury, Statement Regarding Progress on the Review of the U.S. Treasury Market Structure since the July 2015 Joint Staff Report](#) (August 2, 2016).
5. The term “U.S. Treasury security” is defined in Rule 6710(p).
6. Securities Exchange Act Release No. 79116 (October 18, 2016).
7. Unlike other Treasuries, savings bonds issued by the Treasury Department are generally non-transferable and are therefore not marketable securities purchased and sold in the secondary market. See, e.g., 31 CFR 353.15 (providing that Series EE and Series HH “[s]avings bonds are not transferable and are payable only to the owners named on the bonds, except as specifically provided in these regulations and then only in the manner and to the extent so provided”); see also 31 CFR 360.15 (establishing the same transfer provisions for Series I savings bonds).
8. Rule 6710(o) defines a “money market instrument” as “a debt security that at issuance has a maturity of one calendar year or less, or, if a discount note issued by an Agency, as defined in paragraph (k), or a Government-Sponsored Enterprise, as defined in paragraph (n), a maturity of one calendar year and one day or less.” Because money market instruments are excluded from the definition of TRACE-eligible security, the definition of “money market instrument” was amended to exclude U.S. Treasury securities, including U.S. Treasury bills, which have maturities of one year or less. See 31 CFR 356.5(a).
9. At this time, FINRA is not providing, nor requiring reporting of, factor information when reporting transactions in TIPS to TRACE.
10. The STRIPS program is a program operated by the Treasury Department under which eligible securities are authorized to be separated into principal and interest components and transferred separately. See 31 CFR 356.2; see generally 31 CFR 356.31 (providing details on how the STRIPS program works).
11. For purposes of the trade reporting rules, FINRA considers a “trade” or a “transaction” to entail a change of beneficial ownership between parties. See, e.g., Securities Exchange Act Release No. 74482 (March 11, 2015), 80 FR 13940, 13941 (March 17, 2015) (Order Approving SR-FINRA-2014-050); Trade Reporting Frequently Asked Questions, Q100.4, available at [www.finra.org/industry/trade-reporting-faq#100](http://www.finra.org/industry/trade-reporting-faq#100) (defining “trade” and “transaction” for purposes of the equity trade reporting rules as a change in beneficial ownership). For this reason, although

- trading a principal or interest component of a U.S. Treasury security that has been separated under the STRIPS program would constitute a reportable TRACE transaction, the act of separating or reconstituting the components of a U.S. Treasury security under the STRIPS program would not constitute a reportable TRACE transaction. Supplementary Material .05 to Rule 6730 clarifies the reporting obligations in this scenario.
12. All U.S. Treasury securities reportable to TRACE under the amendments are offered to the public by the Treasury Department through an auction process. The regulations governing this process are set forth in Part 356 of Title 31 of the Code of Federal Regulations.
  13. See [Reporting of Corporate and Agencies Debt Frequently Asked Questions](#), Question 4.6. 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. Consequently, repurchase and reverse repurchase transactions are economically equivalent to financings, and the pricing components of these transactions are typically not the market value of the securities.
  14. See Rule 6730(a), (b)(1). The term “party to a transaction” is defined in Rule 6710(e) as “an introducing broker, if any, an executing broker-dealer, or a customer.” For purposes of the definition, the term “customer” includes a broker-dealer that is not a FINRA member. See Rule 6710(e).
  15. TRACE system hours are currently 8:00:00 a.m. Eastern Time through 6:29:59 p.m. Eastern Time on a business day. See Rule 6710(t).
  16. FINRA rules governing trade reporting of equity securities currently require firms to report time to the millisecond if the firm captures time to that level of granularity. See Rule 6380A, Supplementary Material .04; Rule 6380B, Supplementary Material .04; Rule 6622, Supplementary Material .04; see also [Regulatory Notice 14-21](#) (May 2014).
  17. FINRA amended Section 1(b)(2) of Schedule A to the FINRA By-Laws to exclude transactions in U.S. Treasury securities from the Trading Activity Fee (TAF) and amended Rule 7730 to exclude transactions in U.S. Treasury securities from the TRACE transaction reporting fees. However, because FINRA will incur costs to expand the TRACE system and to enhance its examination and surveillance efforts to monitor trading activity in U.S. Treasury securities, it is considering the appropriate long-term funding approach for the program and will analyze potential fee structures once it has more data relating to the size and volume of U.S. Treasury security reporting.
  18. Although FINRA will register CUSIPs for U.S. Treasury securities in the TRACE system, FINRA expects that if a FINRA member firm engages in a reportable TRACE transaction in a TRACE-eligible security that is not in the TRACE system, the firm will inform FINRA so that the CUSIP can be added.