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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-83290; File No. SR-FINRA-2018-020]

### **Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Modify the Definition of “Agency Debt Security”**

May 18, 2018

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 17, 2018, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### **I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change**

FINRA is proposing to amend FINRA Rule 6710 to modify the definition of “Agency Debt Security.”

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

FINRA requires members to report to the Trade Reporting and Compliance Engine ("TRACE") transactions in Agency Debt Securities,<sup>3</sup> which includes those debt securities issued or guaranteed by a Government-Sponsored Enterprise ("GSE"). Fannie Mae ("Fannie") and Freddie Mac ("Freddie"), both of which are GSEs, announced changes relating to the issuance structure of their credit risk transfer securities ("CRTs").<sup>4</sup> Currently, Fannie and Freddie issue CRTs as direct debt obligations, and therefore CRTs fall within the definition of "Agency Debt Security" for purposes of TRACE data categorization and dissemination. FINRA understands that under the new issuance structure, CRTs will be issued by a Fannie- or Freddie-sponsored trust rather than directly by Fannie or Freddie, and proceeds from the sale of the CRTs will be

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<sup>3</sup> "Agency Debt Security" generally includes a debt security (i) issued or guaranteed by an Agency as defined in Rule 6710(k); or (ii) issued or guaranteed by a Government-Sponsored Enterprise as defined in Rule 6710(n). Rule 6710(n) provides that "Government-Sponsored Enterprise" has the same meaning as defined in 2 U.S.C. 622(8).

<sup>4</sup> Fannie and Freddie introduced their respective CRT programs in 2013. CRTs are linked to an underlying loan pool selected and acquired by the GSE and the credit and prepayment performance of the underlying loans determines the performance of the CRTs.

placed in a trust account and managed by a third-party trustee. As a result of CRTs being issued by a trust sponsored by a GSE instead of directly issued by a GSE, CRTs would no longer fall within the technical definition of “Agency Debt Security” and would be considered corporate debt for TRACE data and dissemination purposes. This outcome would be problematic for TRACE subscribers consuming data related to CRTs because transactions in CRTs would no longer be disseminated as part of the Agency Debt data set. In addition, the TRACE system would apply the corporate, rather than Agency, debt transaction size dissemination cap for unrated securities, specifically a \$1 million dissemination cap for unrated corporate debt versus \$5 million for unrated Agency Debt Securities. Thus, classifying CRTs as corporate debt would decrease transparency as to the actual size of the transaction given that unrated corporate debt is disseminated with the \$1, rather than \$5, million dissemination cap.

FINRA believes that the new issuance structure for CRTs will not materially change the characteristics of the CRTs to warrant altered treatment for purposes of TRACE categorization and dissemination. While a trust will be issuing the CRTs, FINRA understands that Fannie and Freddie will retain a material net economic interest<sup>5</sup> in the reference tranches associated with the CRTs issued under the new structure and will enter into a credit protection agreement with the trust, including agreeing to pay any shortfall between the investment earnings on the collateral held by the trust and the one-month LIBOR. Thus, FINRA is proposing to amend Rule 6710(l) to expand the definition of “Agency Debt Security” to include debt issued by a trust or other entity established or sponsored by a GSE for the purpose of issuing debt securities, where the

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<sup>5</sup> See, e.g., Fannie Mae, Prospectus, Connecticut Avenue Securities, Series 2018-C03 Notes Due October 2030, <http://www.fanniemae.com/resources/file/credit-risk/pdf/connav-2018-c03-prospectus.pdf>; see also, e.g., Freddie Mac, Offering Circular, Seasoned Credit Risk Transfer Trust, Series 2017-3, [http://www.freddie.com/seasonedloanofferings/docs/SCRT\\_2017-3\\_OC%20Final.pdf](http://www.freddie.com/seasonedloanofferings/docs/SCRT_2017-3_OC%20Final.pdf).

GSE provides the collateral to the entity or retains a material net economic interest in the securities issued by the entity. This proposed rule would allow CRTs to continue to fall within the definition of “Agency Debt Security” for TRACE purposes and would address any similar future modifications by Fannie and Freddie to other programs.<sup>6</sup> FINRA believes that this would benefit investors by ensuring the continued application of the \$5 million dissemination cap for unrated Agency Debt Securities, instead of the \$1 million dissemination cap for unrated corporate debt. Additionally, continuing to classify CRTs issued under the new issuance structure as Agency Debt Securities would avoid confusion by ensuring that subscribers of the Agency Debt data set continue to receive transaction information on CRTs. Finally, FINRA does not believe that the modification in issuance structure will materially change the characteristics of the CRTs for purposes of TRACE dissemination and, therefore, FINRA does not believe that classifying CRTs as corporate debt solely because of the new issuance structure is warranted.

FINRA has filed the proposed rule change for immediate effectiveness. FINRA has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, so FINRA can implement the proposed rule change immediately.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>7</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles

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<sup>6</sup> FINRA has discussed the proposed rule change with Fannie and Freddie, both of which support the continued inclusion of CRTs within the definition of “Agency Debt Security.”

<sup>7</sup> 15 U.S.C. 78o-3(b)(6).

of trade, and, in general, to protect investors and the public interest. The proposed rule change would prevent investor confusion by providing that CRTs continue to fall within the definition of “Agency Debt Security” for TRACE purposes. In addition, subscribers of the Agency Debt data set would continue to receive transaction information on CRTs, and investors would continue to see CRTs disseminated pursuant to the protocols applicable to Agency Debt Securities that provide a comparatively higher level of transparency as to the actual size of the transaction. As noted above, FINRA does not believe that the new issuance structure will materially change the characteristics of CRTs sufficient to warrant different treatment for TRACE purposes, and believes that the proposal is in the best interest of investors in that it would reduce confusion regarding the appropriate categorization of CRTs.

B. Self-Regulatory Organization’s Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. FINRA does not anticipate that the proposed rule change will lead to any material costs or benefits to members, as it does not affect the TRACE reporting requirements that are applicable today. The proposed rule change would simply allow FINRA to continue classifying the CRTs as Agency Debt Securities for data categorization and dissemination purposes.

C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time

as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>8</sup> and Rule 19b-4(f)(6) thereunder.<sup>9</sup>

FINRA has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing. FINRA has stated that, based on conversations with Fannie and Freddie, it understands that the first CRTs will be issued under the new structure imminently. The Commission believes that waiver of the 30-day operative delay is consistent with the protection of investors and the public interest. Such action should help avoid confusion among consumers of TRACE data products; if the proposal were not immediately operative, debt securities issued by GSE-sponsored trusts that retain economic characteristics of Agency Debt Securities would instead be treated as corporate debt securities, contrary to established expectations. In addition, the Commission's action will preserve the same degree of post-trade transparency for debt securities issued by GSE-sponsored trusts, as such securities will continue utilizing the \$5 million dissemination cap and avoid the \$1 million cap that would apply if securities newly issued by GSE-sponsored trusts were characterized as corporate debt securities. Accordingly, the Commission hereby waives the operative delay and designates the proposed rule change operative upon filing.<sup>10</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the

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<sup>8</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>9</sup> 17 CFR 240.19b-4(f)(6).

<sup>10</sup> For purposes only of waiving the 30-day operative delay, the Commission also has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2018-020 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2018-020. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m.

and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR- FINRA-2018-020, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>11</sup>

**Robert W. Errett,**

*Deputy Secretary.*

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<sup>11</sup> 17 CFR 200.30-3(a)(12).

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