

June 24, 2002

BY ELECTRONIC MAIL AND HAND DELIVERY

Ms. Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: **File No. SR-NASD-2002-63; Amendment No. 3** - Proposed Fees for the Trade Reporting and Compliance Engine ("TRACE") for Corporate Bonds

Dear Ms. England:

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934 ("Act"), the National Association of Securities Dealers, Inc. ("NASD" or "Association") is filing with the Securities and Exchange Commission this response to comments to SR-NASD-2002-63, which proposes a structure for fees to be charged in connection with NASD's Trade Reporting and Compliance Engine (TRACE).¹ The TRACE facility provides for the reporting of transactions and dissemination of transaction information in TRACE-eligible securities as provided in the new Rule 6200 Series (or "TRACE rules").² In Amendment No. 3, NASD proposes to amend the rule filing to reflect a six-month pilot status for the proposed TRACE fees.

The NASD received one comment letter on SR-NASD-2002-63.³ The comments raised several issues. NASD's response is set forth below.

¹ Exchange Act Release No 34-45960 (May 17, 2002), 67 Fed. Reg. 36654 (May 24, 2002), File No. SR-NASD-2002-63.

² The Commission approved the Rule 6200 Series on January 23, 2001. See SR-NASD-99-65 and Amendments No. 1 through 4 thereto, approved in Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 811 (January 29, 2001) ("TRACE Approval Order"). On December 21, 2001, NASD filed SR-NASD-2001-91 to establish July 1, 2002 as the effective date of the Rule 6200 Series (see SR-NASD-2001-91). On January 3, 2002, the Commission issued a notice that the proposed rule change had become effective on filing. Securities Exchange Act Release No. 45229 (January 3, 2002), 67 FR 1255 (January 9, 2002). On April 3, 2002, NASD filed SR-NASD-2002-46 to make certain technical amendments to the new Rule 6200 Series and subsequently filed Amendments No. 1 and 2 thereto.

³ Comment letter from Michel de Konkoly Thege, Vice President and Associate General Counsel, The Bond Market Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated June 14, 2002 ("TBMA Comment Letter").

I. Response to Comments

In an effort to create the market transparency in the bond market as mandated by the Commission, NASD has spent approximately four years developing the TRACE system. NASD has worked extensively with the industry, including representatives of The Bond Market Association (“TBMA”) to develop and implement the TRACE system. In addition, NASD established the Bond Trade Reporting Committee (“BTRC”) one-half of whose members were recommended by TBMA, to provide recommendations to the NASD Board of Governors regarding dissemination of TRACE data.

NASD believes the proposed fees for TRACE are reasonable. NASD staff has determined the proposed fee structure based on the best available information regarding the number of participants, debt securities transaction volume, potential use of data, etc. A number of analyses have been conducted to estimate revenue including requesting a sample of NASD members to estimate transaction volumes and consulting market data vendors about appropriate pricing levels for market data distribution. However, TRACE is a new system for both the industry and NASD and because of this, NASD does not have actual operating history of the system to rely on in determining the proposed fee structure. As such, NASD is strongly committed to reassessing TRACE fees based on actual operating experience as soon as practicable after the launch of the system and within six months or less of the date the system is effective.

Further, in an effort to minimize the cost of reporting transactions, NASD believes the proposed fee structure provides participants with multiple methods by which to report the required information regarding TRACE-eligible securities. Participants can select the method that best meets their requirements based on volume, cost, and other individual needs. A participant may select to report TRACE information through a Computer-to-Computer Interface, a web browser, or through a third-party intermediary. The proposed reporting fees are similar with fees being charged by other transaction reporting facilities and in some cases, i.e., the cancel or correct fee, are designed to ensure accurate reporting. Recognizing that the TRACE system is new and that participants will need time to adjust to the new reporting environment, NASD has proposed that certain reporting fees, such as the “cancel and correct” fee and the “as of” late fee will not be charged until the later of October 1, 2002 or 90 days after the effective date of the TRACE system. The proposed market data fees also allow maximum flexibility for users. A user may select the level of real-time TRACE data that it would like to receive and set up a system accordingly. In addition, certain delayed-time TRACE data will be available on NASD’s website. NASD believes the proposed fees are reasonably related to the costs of developing the new system and meeting estimated operating expenses, including market

surveillance functions, of the TRACE system. NASD remains strongly committed to seek ways to minimize industry costs for reporting their trades and operating the overall system and will continue to seek ways to reduce the ongoing cost structure of the system after its initiation.

Costs of Developing TRACE

Developmental costs of TRACE, to date, are approximately \$7.8 million. Total operating costs for the TRACE system are estimated to be approximately \$6 million annually. These amounts include funding for the regulatory activities necessary for surveillance of the markets and on-going maintenance of the system. Further, these amounts do not include recovery for costs incurred to develop the risk-management and trade comparison features that were originally proposed to be part of the TRACE system. To clarify further, the only development costs included in these estimates are those specifically related to the operation of the current Trace system. In preparing its estimates, NASD has projected to recover developmental costs related to the TRACE system over a period of four years.

Revenues and Underlying Assumptions

NASD recognizes that the TRACE system is new. NASD staff does not have actual operating history of the TRACE system to use as a guide in determining usage, capacity, volume, number of subscribers, number of trades, etc. The proposed fees are based on the best estimates available currently to the staff, including information from FIPS, the industry, and meetings with industry committees. NASD considered suggestions and input from these committees and others in the industry on the proposed TRACE fees; it also considered estimates of costs and revenues and ultimately made the final determination as to the specific fees to be charged. In addition, NASD has been very sensitive to the concerns of small, retail-orientated firms. These small firms believed that the pricing structure of the Fixed Income Pricing System (FIPS) favored large firms over small firms. In order to address this concern, NASD has proposed a sliding scale to more equitably distribute the TRACE transaction reporting fees. Finally, NASD staff has made a commitment to begin to reassess the proposed fee structure as soon as practicable after the initiation of the system and within six months of the TRACE system going live (or sooner, if possible) once actual TRACE usage data is available.

Allocation of Fees

NASD believes the proposed fees have been reasonably allocated, based on total TRACE revenues annually. This allocation is based on NASD estimates of the costs to

develop and operate the system, maintain the system and database, and engage in ongoing member regulation and market surveillance.

Implementing Proposal as a Pilot Program

In recognition of the fact that corporate debt reporting is new, SR-NASD-2002-63 provides a commitment from NASD to review and reassess the proposed TRACE fees as soon as practicable and within six months after the effective date of TRACE, based actual volume, usage, costs, revenues, etc. of the TRACE system. As a more effective mechanism to evaluate the proposed rule change, NASD hereby amends the proposed rule change to provide that TRACE fees will operate as a six-month pilot program. At the end of the six-month period, the pilot program relating to TRACE fees will terminate unless NASD seeks and obtains SEC approval to extend or permanently adopt the proposal, or proposes a revised fee structure for approval. In evaluating whether to seek amendment, extension, or approval of the proposed rule change, NASD will review its experiences with the proposed rule change during the six-month period of the pilot program of TRACE fees.

Accordingly, NASD amends the language of the proposed Rule 7010(k) as follows:

7010(k) Trade Reporting and Compliance Engine (TRACE)

(Rule 7010(k) shall expire on (insert date that is six months after SEC approval of SR-NASD-2002-63), unless amended, extended, or permanently adopted by NASD pursuant to SEC approval at or before such date.)

II. Accelerated Approval of Amendment No. 3

NASD requests that the Commission find good cause pursuant to Section 19(b)(2) of the Securities Exchange Act of 1934 to approve proposed Amendment No. 3 prior to the 30th day after publication in the Federal Register. Although not previously published, the proposed rule change responds to comments and proposes to adopt a pilot status for the TRACE fees.

* * *

If you have any questions, please call Kosha K. Dalal, NASD, Regulatory Policy and Oversight, Office of the General Counsel, at (202) 728-6903; e-mail

Katherine A. England
June 24, 2002
Page 5

kosha.dalal@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Barbara Z. Sweeney
Senior Vice President and
Corporate Secretary

cc: Stephen Williams
Gordon Fuller
Mary Simpkins