

Proposed Rule Change by National Association of Securities Dealers  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

|                                                |                                       |                                        |                                                         |                                                 |                                                 |
|------------------------------------------------|---------------------------------------|----------------------------------------|---------------------------------------------------------|-------------------------------------------------|-------------------------------------------------|
| Initial<br><input checked="" type="checkbox"/> | Amendment<br><input type="checkbox"/> | Withdrawal<br><input type="checkbox"/> | Section 19(b)(2)<br><input checked="" type="checkbox"/> | Section 19(b)(3)(A)<br><input type="checkbox"/> | Section 19(b)(3)(B)<br><input type="checkbox"/> |
|                                                |                                       |                                        | Rule                                                    |                                                 |                                                 |
|                                                |                                       |                                        | <input type="checkbox"/> 19b-4(f)(1)                    | <input type="checkbox"/> 19b-4(f)(4)            |                                                 |
|                                                |                                       |                                        | <input type="checkbox"/> 19b-4(f)(2)                    | <input type="checkbox"/> 19b-4(f)(5)            |                                                 |
|                                                |                                       |                                        | <input type="checkbox"/> 19b-4(f)(3)                    | <input type="checkbox"/> 19b-4(f)(6)            |                                                 |

|                                                              |                                                              |
|--------------------------------------------------------------|--------------------------------------------------------------|
| Exhibit 2 Sent As Paper Document<br><input type="checkbox"/> | Exhibit 3 Sent As Paper Document<br><input type="checkbox"/> |
|--------------------------------------------------------------|--------------------------------------------------------------|

**Description**  
Provide a brief description of the proposed rule change (limit 250 characters).

Proposed Rule 2231 would require members, subject to specified exceptions, to provide customers in debt securities transactions additional, transaction-specific disclosures and would require members to notify customers of the availability of a disclosure document discussing debt securities authored by NASD.

**Contact Information**  
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

|            |                                                        |           |                                             |
|------------|--------------------------------------------------------|-----------|---------------------------------------------|
| First Name | <input type="text" value="James"/>                     | Last Name | <input type="text" value="Eastman"/>        |
| Title      | <input type="text" value="Assistant General Counsel"/> |           |                                             |
| E-mail     | <input type="text" value="james.eastman@nasd.com"/>    |           |                                             |
| Telephone  | <input type="text" value="(202) 728-6961"/>            | Fax       | <input type="text" value="(202) 728-8034"/> |

**Signature**  
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

|      |                                                                               |
|------|-------------------------------------------------------------------------------|
| Date | <input type="text" value="08/19/2005"/>                                       |
| By   | <input type="text" value="Patrice Gliniecki"/>                                |
|      | (Name)                                                                        |
|      | <input type="text" value="Senior Vice President and Deputy General Counsel"/> |
|      | (Title)                                                                       |

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

**Form 19b-4 Information**

[Add](#) [Remove](#) [View](#)

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change**

[Add](#) [Remove](#) [View](#)

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

[Add](#) [Remove](#) [View](#)

Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

[Add](#) [Remove](#) [View](#)

Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

[Add](#) [Remove](#) [View](#)

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

[Add](#) [Remove](#) [View](#)

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

[Add](#) [Remove](#) [View](#)

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

**1. Text of Proposed Rule Change**

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) proposed Rule 2231 that would require members, subject to specified exceptions, to provide customers in debt securities transactions additional, transaction-specific disclosures relating to applicable charges and fees, credit ratings, the availability of last-sale transaction information, and certain interest, yield and call provisions, and would require members to notify customers of the availability of a disclosure document discussing debt securities authored by NASD. Below is the text of the proposed rule change. Proposed new language is underlined.

\* \* \* \* \*

**2231. Confirmation of Transactions in Debt Securities**

**(a) Confirmation of Transactions in Debt Securities**

(1) Except as otherwise provided herein, any member that is required to disclose to a customer information pursuant to Rule 10b-10 under the Act in connection with any transaction in a debt security also shall disclose to the customer the information set forth in paragraph (b). Except as otherwise provided herein, this information shall be disclosed in the same manner in which the member discloses to the customer information in connection with the transaction pursuant to Rule 10b-10 under the Act. Transactions by a member’s institutional customers are not subject to this Rule. A member need not disclose to customers information required to be disclosed under this Rule if the member discloses such

information pursuant to Rule 10b-10 under the Act.

(2) For purposes of this Rule:

(A) “institutional customer” means a customer that, within the past twelve months the member has determined, is a "qualified purchaser" as defined in Section 2(a)(51) of the Investment Company Act of 1940;

(B) “debt security” shall have the same meaning it has in Rule 10b-10 under the Act, except that any exempted security or asset-backed security is excluded from this definition;

(C) “exempted security” shall have the same meaning it has in Section 3(a)(12) of the Act;

(D) “asset-backed security” shall have the same meaning it has in Rule 10b-10 under the Act;

(E) “nationally recognized statistical rating organization” (“NRSRO”) shall have the same meaning it has when used in Rule 15(c)(3)-1 under the Act;

(F) “clearing member” shall have the same meaning it has when used in Rule 3230; and

(G) “service bureau” shall have the same meaning it has when used in IM-4632-1 under Rule 4632.

**(b) Information Required to be Disclosed**

(1) Debt security information. Disclose the debt security’s CUSIP\*, and, if it is a TRACE-eligible security, the TRACE symbol of the debt security if one has been designated by NASD.

\*“CUSIP” stands for Committee on Uniform Securities Identification Procedures. CUSIP numbers belong to Standard and Poor's, a division of the McGraw-Hill Companies, Inc. (“S&P”). S&P's CUSIP numbers are proprietary to S&P and are protected by copyright and other intellectual property laws. S&P licenses to NASD the use of the terms “Committee on Uniform Securities Identification Procedures” and “CUSIP,” which may not be copied or otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed or resold, or stored for subsequent use for any such purposes, in whole or in part, in any form or manner or by any means whatsoever, by any person without S&P's prior written consent.

(2) *Broker-dealer charges.* Disclose in a text field labeled “Broker-Dealer Charges” one of the following statements if applicable:

(A) If the member acted as principal, purchased a debt security from the customer, and reduced the proceeds paid to the customer by a payment for its services, “the proceeds you received from the debt security you sold were reduced by a payment to our firm for its services”; or

(B) If the member acted as principal, sold a debt security to the customer, and incorporated a payment to the member in the price paid by the customer, “a payment to our firm for its services was incorporated in the price you paid for the debt security you purchased.”

(3) Credit rating. A member must disclose the credit rating(s) as of the time of the transaction and the NRSRO(s) assigning the credit rating(s), if:

(A) the member has entered into a written agreement with the NRSRO to receive such credit ratings;

(B) a service bureau that provides confirmation services to the member for the transaction has entered into a written agreement with the NRSRO to receive such credit ratings and provides them to the member as part of the confirmation at no additional cost; or

(C) a member that acts as a clearing member for, and provides confirmation services to, the member for the transaction has entered into a written agreement with the NRSRO to receive such credit ratings and provides them to the member as part of the confirmation at no additional cost.

(4) Indicators of marketability and liquidity. Disclose whether transaction price information on the debt security is publicly available and if it is, that a customer may, if the debt security is a TRACE-eligible security, obtain such information at the internet Web site [www.nasdbondinfo.com](http://www.nasdbondinfo.com) for the customer's non-commercial use at no charge, or at other sources that provide such information.

(5) Cash flow information. For purchases only, disclose on a per debt security basis the following:

(A) The frequency of interest and principal payments.

(B) Yield to maturity, and, if the debt security is callable, whether the debt security is continuously callable or otherwise callable, and the next occurring call date and associated call price.

(C) For debt securities carrying a variable coupon rate, disclosure indicating that the coupon rate may vary and that the member will provide in writing additional information relating to the calculation of the debt security's interest and principal payments upon a written request from the customer that is sent not later than six months from the date of settlement. Members shall provide such additional information to any customer to whom disclosure is provided under this Rule within three business days of receiving the customer's request. Any such additional information shall contain:

(i) the amount of the next interest payment based on the current coupon rate,

(ii) a statement that this amount will change if the coupon rate changes,

(iii) how often the coupon rate may be recalculated,

(iv) an explanation of the event(s) that may trigger the recalculation, and

(v) the formula for recalculating such coupon rate.

(D) For purchases of debt securities that are callable and, at issue, are not structured to include scheduled interest payments (e.g., "zero coupon bonds"), the dollar equivalent of the debt security's imputed

interest until the next occurring call date (assuming that the price at which the debt security may be called is paid to the holder).

(6) Notice of availability of NASD disclosure.

(A) Except as otherwise provided in subparagraph (B) below, the following statement must appear in a clear and conspicuous manner in any disclosure provided pursuant to this paragraph (b): “A disclosure document discussing your rights as a bondholder and some of the risks related to buying and holding bonds, titled ‘Important Information You Need to Know About Investing in Corporate Bonds,’ has been prepared by NASD and is available online at [www.nasd.com](http://www.nasd.com). A paper version of this document is available from your broker upon your written request made not later than six months from the date of settlement of your transaction.”

(B) In lieu of disclosing the internet Web site address “[www.nasd.com](http://www.nasd.com)” in the statement set forth in subparagraph (A), a member may disclose the member’s internet Web site address, provided that the document, “Important Information You Need to Know About Investing in Corporate Bonds,” or an internet hyperlink directly thereto, is easily accessible from the internet address that is disclosed.

(C) Members must provide the document, “Important Information You Need to Know About Investing in Corporate Bonds,” to any customer to whom disclosure is provided under this Rule within three business days of receiving the customer’s request.

\* \* \* \* \*

**2. Procedures of the Self-Regulatory Organization**

The proposed rule change was approved by the Board of Governors of NASD at its meeting of January 27, 2005, which authorized the filing of the proposed rule change with the SEC. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the Board of Governors of NASD to adopt NASD Rules without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be not later than nine months following publication of the Notice to Members announcing Commission approval.

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

(a) Purpose

Background. With the implementation of NASD's Trade Reporting and Compliance Engine ("TRACE") in 2002 and the subsequent availability of a consolidated view of transaction information in the U.S. corporate bond market, a number of trends have emerged that have implications for the regulatory framework of the corporate debt market. For example, approximately 65% of TRACE transactions are for amounts of less than \$100,000, indicating significant individual investor participation in the corporate bond market.<sup>1</sup> In addition, there appears to be greater individual investor awareness of the role that corporate bonds may play in a diversified investment portfolio. NASD

---

<sup>1</sup> See Notice to Members 05-21 (April 2005).

believes that ensuring that investors understand some of the key characteristics of particular bonds that they are buying or selling as well as the key risks associated with bond investing is an important element of its efforts to enhance transparency in the corporate debt market.

The proposed rule change is based upon issues raised and recommendations developed by the Corporate Debt Market Panel (“Panel”), which was convened by NASD to review and make recommendations to the NASD’s Board of Governors regarding how to best ensure market integrity and investor protection in the corporate bond market.<sup>2</sup>

The Panel reviewed information showing significant levels of participation by individual investors in the corporate bond market<sup>3</sup> as well as NASD surveys showing that individual investors often do not understand certain key structural aspects of specific bonds or the market in which bonds are traded. For example, 34% of individuals surveyed did not believe that they were paying a fee for buying or selling a bond and approximately 60% of investors surveyed did not understand that bond prices generally fall as interest rates rise.<sup>4</sup> The Panel concluded that individual investors would benefit from additional guidance and information disclosure, and recommended, among other things, that investors obtain improved access to information on bonds and receive increased disclosures regarding their bond transactions. The proposed rule change is based on the

---

<sup>2</sup> See Report of the Corporate Debt Market Panel, September 2004, at [www.nasd.com/pdf\\_text/corp\\_debt\\_panel\\_report.pdf](http://www.nasd.com/pdf_text/corp_debt_panel_report.pdf) (“Panel Report”) (containing Panel’s findings and recommendations).

<sup>3</sup> The Panel Report notes that information obtained from TRACE shows that approximately “two thirds of corporate bond transactions reported to TRACE are in quantities of \$100,000 or less in value, a size widely viewed as representative of individual investor activity.” Panel Report at 4.

Panel's recommendations and also reflects significant input from other NASD advisory committees, such as NASD's Fixed Income Committee.

Proposed Disclosures. Proposed Rule 2231 would require members, subject to specified exceptions, to provide customers in debt securities transactions, in the same manner in which they provide information to the customer pursuant to SEC Rule 10b-10,<sup>5</sup> additional, transaction-specific disclosures relating to applicable charges and fees, credit ratings, the availability of last-sale transaction information, and certain interest, yield and call provisions, and would require members to notify customers of the availability of a disclosure document discussing debt securities authored by NASD.<sup>6</sup> Importantly, under proposed Rule 2231(a) members would not be required to make any of the disclosures, which are specified in proposed paragraph (b), that would be duplicative of a disclosure already required under SEC Rule 10b-10 for that transaction. Also, under proposed Rule 2231(a), unless otherwise provided, the information would be required to be disclosed in the same manner (e.g., frequency) in which the member discloses information to the customer about the specific debt transaction pursuant to SEC Rule 10b-10.<sup>7</sup> However, NASD would not interpret proposed Rule 2231 as requiring

---

<sup>4</sup> Panel Report at 4.

<sup>5</sup> 17 CFR 240.10b-10.

<sup>6</sup> For purposes of proposed Rule 2231, "debt security" is defined to have the same meaning it has under SEC Rule 10b-10.

<sup>7</sup> For example, the Commission has provided exemptive relief to broker-dealer sponsors of "wrap fee programs" to permit those broker-dealers to confirm transactions in their wrap fee programs through periodic statements, not less often than quarterly (subject to several conditions), in lieu of immediate trade confirmations that otherwise would be required under SEC Rule 10b-10. See Money Management Institute, Securities Industry Association (August 23, 1999); 1999 SEC No-Act Lexis 934 (SEC's Division of Market Regulation grants

members to provide the required supplemental disclosures on the same piece of paper or electronic document (if the confirmation is provided electronically) as that containing the SEC Rule 10b-10 confirmation. NASD believes that requiring the information required by SEC Rule 10b-10 and proposed Rule 2231 to be displayed on the same piece of paper or electronic document (if the confirmation is provided electronically) could potentially be unwieldy without materially improving investor protection.

The specific additional disclosures in proposed Rule 2231(b)(1) would include the CUSIP, and the TRACE symbol, if available, to assure that the transaction is identified as clearly as possible. In proposed Rule 2231(b)(2), a member would be required to select and disclose, if applicable, a statement relating to transaction charges (*i.e.*, mark-ups, mark-downs and fees).<sup>8</sup> These standard disclosures are intended to clarify for investors, especially those dealing with a member acting as a principal, whether a member has obtained any remuneration in connection with the customer's debt securities transaction, since, under SEC Rule 10b-10, agency commissions are required to be disclosed, but a principal's mark-up or mark-down is not. In proposed Rule 2231(b)(3), the credit rating of the security, must be disclosed. A member would be required to disclose the credit rating if it, or the clearing firm or service bureau providing confirmation services to the member on the transaction, has entered into a written agreement with a ratings agency to

---

industry-wide exemptive relief on behalf of the Commission pursuant to delegated authority). NASD generally would defer to SEC and SEC staff interpretations of SEC Rule 10b-10 when interpreting proposed Rule 2231's delivery requirements, and members properly relying upon such interpretations for purposes of satisfying SEC Rule 10b-10's delivery requirements also would be deemed to satisfy proposed Rule 2231's delivery requirements.

<sup>8</sup> NASD is not proposing to require that the amount of the member's mark-up or mark-down be disclosed.

receive such credit ratings, and, in the case of a clearing firm or service bureau, those ratings are made available to the member for inclusion on the transaction confirmation at no additional cost.<sup>9</sup> Under proposed Rule 2231(b)(4), a member would be required to disclose whether transaction price information is publicly available for the security.

For customer purchases only, under proposed Rule 2231(b)(5), members would be required to provide the frequency of interest and principal payments and yield to maturity. For variable rate debt securities, the customer would be required to be informed that the coupon rate may vary and be notified that the member will provide additional information in writing about the variable debt upon the customer's request as specified in proposed Rule 2231(b)(5)(C). Finally, when a member sells a zero coupon bond to a customer, under proposed Rule 2231(b)(5)(D), the member would be required to provide certain additional information about the bond.

Proposed Disclosure Document. In addition to the disclosures discussed above that are specific to the debt security purchased or sold in a particular transaction, proposed Rule 2231(b)(6) would require members to notify customers of the location and availability of an NASD-authored disclosure document that discusses investing in bonds, titled "Important Information You Need to Know About Investing in Bonds."<sup>10</sup> Members would be permitted to provide customers with the NASD's internet Web site address

---

<sup>9</sup> For example, it is NASD's understanding that certain large clearing firms offer to disclose on a correspondent firm's transaction confirmation a "menu" of items for a fixed fee and that credit rating information typically is included as one of these menu items. A member who receives credit ratings information and whose clearing firm also receives credit ratings information would be permitted to choose which credit ratings to disclose.

<sup>10</sup> See Exhibit A in Notice to Members 05-21, at 13-17.

where the disclosure document is located, or the member's own internet Web site address, provided that the disclosure document, or an internet hyperlink directly thereto, is easily accessible from the internet address that is provided to customers. Members would be required to provide a paper copy of this document upon request, but would be permitted to provide this document in electronic form (e.g., as an attachment to an e-mail) if the customer requests that it be delivered in electronic form.

NASD has prepared the proposed disclosure document because NASD believes that individual investors need more information generally regarding the purchase and sale of bonds. The information should aid an investor in determining whether a bond is an appropriate investment given the investor's investment objectives, whether the bond's price is comparable to other reported transactions in the same or a similar security, and the bond's overall risk/return. NASD describes various types of corporate bonds and their common features or provisions (e.g., coupon rate, face value, and maturity), as well as certain important risks that should be considered when investing in debt securities, such as interest rate risk, call and reinvestment risk, refunding risk (and sinking fund provisions), and default and credit risk (including the differences between subordinated and non-subordinated debt). The document also addresses other topics, including but not limited to bond pricing, the relationship between price and yield, and the differences between a bond's yield to maturity and its yield to call.

Exceptions. In Rule 2231, there are three significant exceptions to the general requirement that members provide supplemental disclosures to customers in connection with debt securities transactions. First, proposed Rule 2231 does not extend to transactions between a member and its institutional customers. "Institutional customer"

would be defined to mean a “qualified purchaser” as defined under the Investment Company Act of 1940.<sup>11</sup> The second and third exceptions exclude transactions in “exempted securities” as defined in Section 3(a)(12)<sup>12</sup> of the Act and “asset-backed securities” as defined in SEC Rule 10b-10.<sup>13</sup>

As noted in Item 2 of this filing, NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be not later than nine months following publication of the Notice to Members announcing Commission approval.

---

<sup>11</sup> The term “qualified purchaser” is defined in Section 2(a)(51) of the Investment Company Act of 1940, which provides, in pertinent part:

[A]ny natural person (including any person who holds a joint, community property, or other similar shared ownership interest in an issuer that is excepted under section 3(c)(7) [15 USCS § 80a-3(c)(7)] with that person's qualified purchaser spouse) who owns not less than \$5,000,000 in investments, as defined by the Commission ... or any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than \$25,000,000 in investments....

15 U.S.C. 80A-2(a)(51)(A)(i).

<sup>12</sup> 15 U.S.C. 78c(a)(12).

<sup>13</sup> Exchange Act Section 3(a)(12)’s definition of “exempted security” covers a variety of securities including government securities, municipal securities, an interest or participation in certain trust funds, pooled income funds and collective investment funds, and securities issued in connection with certain qualified plans and church plans. “Asset-backed security” is defined in Rule 10b-10(d)(10) to mean:

[A] security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the security holders.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. Specifically, the proposed rule change would provide investors with information with which they might better assess the quality of their executions in debt securities transactions, the fees charged and whether the security purchased fits their investment goals.

**4. Self-Regulatory Organization's Statement on Burden on Competition**

NASD 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, as amended.

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

NASD requested comment on proposed Rule 2231, including the proposed disclosure document, in Notice to Members 05-21. NASD received eleven comment letters in response to Notice to Members 05-21. Commenters generally supported the underlying goals of the proposed rule change. One commenter stated that the proposed rule change represents an important advancement for transparency in the retail corporate debt market.

Most commenters believed that the proposed rule change would require significant operational changes and should be implemented on a delayed basis with at least a six-month delayed effective date, although certain commenters believed that the

delay period should be as long as 18 months. NASD has considered members' comments carefully and believes that it is important for providing adequate notice to members to allow members to prepare operationally to provide customers additional disclosures for each debt securities transaction. At this time, NASD preliminarily has determined that, following the approval of the proposed rule change by the SEC, if obtained, the proposed rule would become effective no later than nine months following such approval.

One commenter indicated that the costs of the proposed rule change would outweigh its benefits if it does not contain a point-of-sale delivery requirement. NASD initially considered proposing a point-of-sale delivery requirement, but after extensive deliberations that included input from relevant NASD advisory committees, NASD concluded that the costs associated with such an approach, particularly the operational burden it would impose on firms, would not, at this time, be outweighed by the incremental marginal enhancement of investor protection that NASD anticipates might be achieved, particularly when compared to the confirmation disclosure approach that has been proposed.

Certain commenters suggested that the proposed definition of "institutional investor" used in the proposed rule change would be difficult to administer on a transaction-by-transaction basis and suggested using a transaction level threshold such as \$100,000 to determine which transactions trigger the disclosure requirement (i.e., anything over \$100,000 would be excluded).

NASD carefully considered these comments, but has decided that, on balance, the proposed definition of institutional investor is a more appropriate standard given the exemptive nature of this provision. Additionally, it is NASD's understanding, based on

feedback from industry experts, that market participants generally are familiar with the application of the “Qualified Purchaser” standard as well as the related Commission and SEC staff interpretations. However, NASD agrees with the commenters that the costs and operational burdens that would be incurred in determining if a customer is an institutional customer on a transaction-by-transaction basis would be significant. In response to these comments, NASD has modified proposed Rule 2231(a)(2)(A) to make clear that members only would be required to make such a determination with regard to a particular customer once every twelve months.

Several commenters suggested that the proposed CUSIP disclosure would be sufficient and that disclosure of a debt security’s TRACE symbol would not be useful to investors, and would add unnecessary costs. NASD has carefully considered these views, but believes that disclosing TRACE symbols when they exist will enhance investor understanding of corporate bond pricing because the TRACE symbols are generally alphabetical symbols and closely resemble the name of the issuer and/or the alphabetical symbols used for the issuer’s equity securities, thereby allowing investors to more easily identify one or more bonds. NASD believes that the estimated positive impact on investor use and comprehension of corporate bond market data would justify the marginal cost associated with requiring such disclosures to be made.

The proposal published in Notice to Members 05-21 would have required a mandatory field labeled “brokerage charges” in which one of three specified statements would have appeared, as applicable. Commenters agreed that fees and charges involved in a transaction should be clearly disclosed to customers, but expressed concerns that as proposed, this disclosure would, in certain cases, incorrectly suggest the existence of an

agency relationship. In response to these comments, NASD has proposed re-naming the “brokerage charges” field the “broker-dealer charges” field, has eliminated the proposed disclosure for agency transactions to avoid potential confusion, and has modified the text of the two remaining fields.

As initially published in Notice to Members 05-21, the proposed rule change would have required a member to disclose any credit rating of a debt security rated by a nationally recognized statistical rating organization (“NRSRO”) to which the member subscribes. Some commenters sought clarification on the specific meaning of the term “subscribes.” In response to these comments, NASD has clarified proposed Rule 2231(b)(3) by eliminating the use of the term “subscribes” and requiring that members comply with the credit rating disclosure requirement if a member or its clearing firm or service bureau providing confirmation services on that transaction has “entered into a written agreement with the NRSRO to receive such credit ratings.”

Many commenters believe that all members should be required to comply with the credit rating disclosure requirement regardless of whether they already receive such information from an NRSRO. NASD has not proposed this requirement at this time, but if the proposed rule change is approved by the Commission, NASD intends to monitor the percentage of firms that subscribe to and/or disclose NRSRO credit ratings to customers under proposed Rule 2231. If a uniform practice of disclosure of NRSRO ratings does not arise, NASD will consider the advisability of mandating at least one subscription to an NRSRO. Additionally, NASD has expanded this proposed requirement to also cover members whose clearing firm or service bureau subscribes to a credit rating service of an NRSRO. NASD believes that this provision will serve to

achieve a higher degree of uniformity than if the proposed provision applied only to members who maintain such subscriptions.

Certain commenters urged NASD to permit members to provide disclosures on frequency of interest and principal payments only when an investor specifically requests them. Additionally, it was recommended that NASD allow firms to satisfy this rule in any manner that conveys the frequency of payments. NASD has determined to propose these provisions as they were published in Notice to Members 05-21. NASD carefully considered these comments and has balanced what it and the Panel perceive as the need for investors to have this particular information with the cost imposed on members in providing this information.

Additionally, commenters generally supported the disclosure of enhanced yield information, but did raise concerns about how yield would be required to be calculated. Generally, NASD intends to defer to the Commission and SEC staff's body of interpretive guidance interpreting SEC Rule 10b-10 on such issues if relevant guidance has been issued or otherwise provided.<sup>14</sup>

Finally, the majority of commenters agreed that educational information on corporate bond investing should be available to the public, but differed as to the logistics of making such materials available. Many commenters, however, were concerned about

---

<sup>14</sup> See supra note 7.

customers suffering from securities regulatory disclosure “information overload.” NASD is sensitive to these concerns, but believes that the disclosure document containing educational information strikes an appropriate balance between being concise while focusing on the major risks associated with investing in the corporate bond market.

**6. Extension of Time Period for Commission Action**

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

**7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

Not applicable.

**8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission**

Not applicable.

**9. Exhibits**

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

**EXHIBIT 1**

**SECURITIES AND EXCHANGE COMMISSION**

(Release No. 34- ; File No. SR-NASD-2005-100)  
**SELF-REGULATORY ORGANIZATIONS**

Proposed Rule Change by National Association of Securities Dealers, Inc.  
Relating to Requiring Members to Provide Customers in Debt Securities Transactions  
Additional, Transaction-Specific Disclosures and to Notify Customers of the Availability  
of a Disclosure Document

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 , the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. 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**

NASD is proposing to adopt Rule 2231, to require members, subject to specified exceptions, to provide customers in debt securities transactions additional, transaction-specific disclosures relating to applicable charges and fees, credit ratings, the availability of last-sale transaction information, and certain interest, yield and call provisions, and would require members to notify customers of the availability of a disclosure document

---

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

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

discussing debt securities authored by NASD. Below is the text of the proposed rule change. Proposed new language is in italics.

\* \* \* \* \*

**2231. Confirmation of Transactions in Debt Securities**

**(a) Confirmation of Transactions in Debt Securities**

(1) Except as otherwise provided herein, any member that is required to disclose to a customer information pursuant to Rule 10b-10 under the Act in connection with any transaction in a debt security also shall disclose to the customer the information set forth in paragraph (b). Except as otherwise provided herein, this information shall be disclosed in the same manner in which the member discloses to the customer information in connection with the transaction pursuant to Rule 10b-10 under the Act. Transactions by a member's institutional customers are not subject to this Rule. A member need not disclose to customers information required to be disclosed under this Rule if the member discloses such information pursuant to Rule 10b-10 under the Act.

(2) For purposes of this Rule:

(A) "institutional customer" means a customer that, within the past twelve months the member has determined, is a "qualified purchaser" as defined in Section 2(a)(51) of the Investment Company Act of 1940;

(B) "debt security" shall have the same meaning it has in Rule 10b-10 under the Act, except that any exempted security or asset-backed security is excluded from this definition;

(C) "exempted security" shall have the same meaning it has in

Section 3(a)(12) of the Act;

(D) “asset-backed security” shall have the same meaning it has in Rule 10b-10 under the Act;

(E) “nationally recognized statistical rating organization” (“NRSRO”) shall have the same meaning it has when used in Rule 15(c)(3)-1 under the Act;

(F) “clearing member” shall have the same meaning it has when used in Rule 3230; and

(G) “service bureau” shall have the same meaning it has when used in IM-4632-1 under Rule 4632.

**(b) Information Required to be Disclosed**

(1) Debt security information. Disclose the debt security’s CUSIP\*, and, if it is a TRACE-eligible security, the TRACE symbol of the debt security if one has been designated by NASD.

\*“CUSIP” stands for Committee on Uniform Securities

Identification Procedures. CUSIP numbers belong to Standard and Poor's, a division of the McGraw-Hill Companies, Inc. (“S&P”).

S&P's CUSIP numbers are proprietary to S&P and are protected by

copyright and other intellectual property laws. S&P licenses to

NASD the use of the terms “Committee on Uniform Securities

Identification Procedures” and “CUSIP,” which may not be copied

or otherwise reproduced, repackaged, further transmitted,

transferred, disseminated, redistributed or resold, or stored for

subsequent use for any such purposes, in whole or in part, in any form or manner or by any means whatsoever, by any person without S&P's prior written consent.

(2) Broker-dealer charges. Disclose in a text field labeled "Broker-Dealer Charges" one of the following statements if applicable:

(A) If the member acted as principal, purchased a debt security from the customer, and reduced the proceeds paid to the customer by a payment for its services, "the proceeds you received from the debt security you sold were reduced by a payment to our firm for its services"; or

(B) If the member acted as principal, sold a debt security to the customer, and incorporated a payment to the member in the price paid by the customer, "a payment to our firm for its services was incorporated in the price you paid for the debt security you purchased."

(3) Credit rating. A member must disclose the credit rating(s) as of the time of the transaction and the NRSRO(s) assigning the credit rating(s), if:

(A) the member has entered into a written agreement with the NRSRO to receive such credit ratings;

(B) a service bureau that provides confirmation services to the member for the transaction has entered into a written agreement with the NRSRO to receive such credit ratings and provides them to the member as part of the confirmation at no additional cost; or

(C) a member that acts as a clearing member for, and provides confirmation services to, the member for the transaction has entered into a

written agreement with the NRSRO to receive such credit ratings and provides them to the member as part of the confirmation at no additional cost.

(4) Indicators of marketability and liquidity. Disclose whether transaction price information on the debt security is publicly available and if it is, that a customer may, if the debt security is a TRACE-eligible security, obtain such information at the internet Web site [www.nasdbondinfo.com](http://www.nasdbondinfo.com) for the customer's non-commercial use at no charge, or at other sources that provide such information.

(5) Cash flow information. For purchases only, disclose on a per debt security basis the following:

(A) The frequency of interest and principal payments.

(B) Yield to maturity, and, if the debt security is callable, whether the debt security is continuously callable or otherwise callable, and the next occurring call date and associated call price.

(C) For debt securities carrying a variable coupon rate, disclosure indicating that the coupon rate may vary and that the member will provide in writing additional information relating to the calculation of the debt security's interest and principal payments upon a written request from the customer that is sent not later than six months from the date of settlement. Members shall provide such additional information to any customer to whom disclosure is provided under this Rule within three business days of

receiving the customer's request. Any such additional information shall contain:

(i) the amount of the next interest payment based on the current coupon rate,

(ii) a statement that this amount will change if the coupon rate changes,

(iii) how often the coupon rate may be recalculated,

(iv) an explanation of the event(s) that may trigger the recalculation, and

(v) the formula for recalculating such coupon rate.

(D) For purchases of debt securities that are callable and, at issue, are not structured to include scheduled interest payments (e.g., "zero coupon bonds"), the dollar equivalent of the debt security's imputed interest until the next occurring call date (assuming that the price at which the debt security may be called is paid to the holder).

(6) Notice of availability of NASD disclosure.

(A) Except as otherwise provided in subparagraph (B) below, the following statement must appear in a clear and conspicuous manner in any disclosure provided pursuant to this paragraph (b): "A disclosure document discussing your rights as a bondholder and some of the risks related to buying and holding bonds, titled 'Important Information You Need to Know About Investing in Corporate Bonds,' has been prepared by NASD and is available online at [www.nasd.com](http://www.nasd.com). A paper version of this

document is available from your broker upon your written request made not later than six months from the date of settlement of your transaction.”

(B) In lieu of disclosing the internet Web site address “www.nasd.com” in the statement set forth in subparagraph (A), a member may disclose the member’s internet Web site address, provided that the document, “Important Information You Need to Know About Investing in Corporate Bonds,” or an internet hyperlink directly thereto, is easily accessible from the internet address that is disclosed.

(C) Members must provide the document, “Important Information You Need to Know About Investing in Corporate Bonds,” to any customer to whom disclosure is provided under this Rule within three business days of receiving the customer’s request.

\* \* \* \* \*

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

In its filing with the Commission, NASD 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. NASD 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**

Background. With the implementation of NASD's Trade Reporting and Compliance Engine ("TRACE") in 2002 and the subsequent availability of a consolidated view of transaction information in the U.S. corporate bond market, a number of trends have emerged that have implications for the regulatory framework of the corporate debt market. For example, approximately 65% of TRACE transactions are for amounts of less than \$100,000, indicating significant individual investor participation in the corporate bond market.<sup>3</sup> In addition, there appears to be greater individual investor awareness of the role that corporate bonds may play in a diversified investment portfolio. NASD believes that ensuring that investors understand some of the key characteristics of particular bonds that they are buying or selling as well as the key risks associated with bond investing is an important element of its efforts to enhance transparency in the corporate debt market.

The proposed rule change is based upon issues raised and recommendations developed by the Corporate Debt Market Panel ("Panel"), which was convened by NASD to review and make recommendations to the NASD's Board of Governors regarding how to best ensure market integrity and investor protection in the corporate bond market.<sup>4</sup> The Panel reviewed information showing significant levels of participation by individual investors in the corporate bond market<sup>5</sup> as well as NASD surveys showing that individual

---

<sup>3</sup> See Notice to Members 05-21 (April 2005).

<sup>4</sup> See Report of the Corporate Debt Market Panel, September 2004, at [www.nasd.com/pdf\\_text/corp\\_debt\\_panel\\_report.pdf](http://www.nasd.com/pdf_text/corp_debt_panel_report.pdf) ("Panel Report") (containing Panel's findings and recommendations).

<sup>5</sup> The Panel Report notes that information obtained from TRACE shows that approximately "two thirds of corporate bond transactions reported to TRACE are

investors often do not understand certain key structural aspects of specific bonds or the market in which bonds are traded. For example, 34% of individuals surveyed did not believe that they were paying a fee for buying or selling a bond and approximately 60% of investors surveyed did not understand that bond prices generally fall as interest rates rise.<sup>6</sup> The Panel concluded that individual investors would benefit from additional guidance and information disclosure, and recommended, among other things, that investors obtain improved access to information on bonds and receive increased disclosures regarding their bond transactions. The proposed rule change is based on the Panel's recommendations and also reflects significant input from other NASD advisory committees, such as NASD's Fixed Income Committee.

Proposed Disclosures. Proposed Rule 2231 would require members, subject to specified exceptions, to provide customers in debt securities transactions, in the same manner in which they provide information to the customer pursuant to SEC Rule 10b-10,<sup>7</sup> additional, transaction-specific disclosures relating to applicable charges and fees, credit ratings, the availability of last-sale transaction information, and certain interest, yield and call provisions, and would require members to notify customers of the availability of a disclosure document discussing debt securities authored by NASD.<sup>8</sup> Importantly, under proposed Rule 2231(a) members would not be required to make any of the disclosures,

---

in quantities of \$100,000 or less in value, a size widely viewed as representative of individual investor activity.” Panel Report at 4.

<sup>6</sup> Panel Report at 4.

<sup>7</sup> 17 CFR 240.10b-10.

<sup>8</sup> For purposes of proposed Rule 2231, “debt security” is defined to have the same meaning it has under SEC Rule 10b-10.

which are specified in proposed paragraph (b), that would be duplicative of a disclosure already required under SEC Rule 10b-10 for that transaction. Also, under proposed Rule 2231(a), unless otherwise provided, the information would be required to be disclosed in the same manner (e.g., frequency) in which the member discloses information to the customer about the specific debt transaction pursuant to SEC Rule 10b-10.<sup>9</sup> However, NASD would not interpret proposed Rule 2231 as requiring members to provide the required supplemental disclosures on the same piece of paper or electronic document (if the confirmation is provided electronically) as that containing the SEC Rule 10b-10 confirmation. NASD believes that requiring the information required by SEC Rule 10b-10 and proposed Rule 2231 to be displayed on the same piece of paper or electronic document (if the confirmation is provided electronically) could potentially be unwieldy without materially improving investor protection.

The specific additional disclosures in proposed Rule 2231(b)(1) would include the CUSIP, and the TRACE symbol, if available, to assure that the transaction is identified as clearly as possible. In proposed Rule 2231(b)(2), a member would be required to select

---

<sup>9</sup> For example, the Commission has provided exemptive relief to broker-dealer sponsors of “wrap fee programs” to permit those broker-dealers to confirm transactions in their wrap fee programs through periodic statements, not less often than quarterly (subject to several conditions), in lieu of immediate trade confirmations that otherwise would be required under SEC Rule 10b-10. See Money Management Institute, Securities Industry Association (August 23, 1999); 1999 SEC No-Act Lexis 934 (SEC’s Division of Market Regulation grants industry-wide exemptive relief on behalf of the Commission pursuant to delegated authority). NASD generally would defer to SEC and SEC staff interpretations of SEC Rule 10b-10 when interpreting proposed Rule 2231’s delivery requirements, and members properly relying upon such interpretations for purposes of satisfying SEC Rule 10b-10’s delivery requirements also would be deemed to satisfy proposed Rule 2231’s delivery requirements.

and disclose, if applicable, a statement relating to transaction charges (i.e., mark-ups, mark-downs and fees).<sup>10</sup> These standard disclosures are intended to clarify for investors, especially those dealing with a member acting as a principal, whether a member has obtained any remuneration in connection with the customer's debt securities transaction, since, under SEC Rule 10b-10, agency commissions are required to be disclosed, but a principal's mark-up or mark-down is not. In proposed Rule 2231(b)(3), the credit rating of the security, must be disclosed. A member would be required to disclose the credit rating if it, or the clearing firm or service bureau providing confirmation services to the member on the transaction, has entered into a written agreement with a ratings agency to receive such credit ratings, and, in the case of a clearing firm or service bureau, those ratings are made available to the member for inclusion on the transaction confirmation at no additional cost.<sup>11</sup> Under proposed Rule 2231(b)(4), a member would be required to disclose whether transaction price information is publicly available for the security.

For customer purchases only, under proposed Rule 2231(b)(5), members would be required to provide the frequency of interest and principal payments and yield to maturity. For variable rate debt securities, the customer would be required to be informed that the coupon rate may vary and be notified that the member will provide

---

<sup>10</sup> NASD is not proposing to require that the amount of the member's mark-up or mark-down be disclosed.

<sup>11</sup> For example, it is NASD's understanding that certain large clearing firms offer to disclose on a correspondent firm's transaction confirmation a "menu" of items for a fixed fee and that credit rating information typically is included as one of these menu items. A member who receives credit ratings information and whose clearing firm also receives credit ratings information would be permitted to choose which credit ratings to disclose.

additional information in writing about the variable debt upon the customer's request as specified in proposed Rule 2231(b)(5)(C). Finally, when a member sells a zero coupon bond to a customer, under proposed Rule 2231(b)(5)(D), the member would be required to provide certain additional information about the bond.

Proposed Disclosure Document. In addition to the disclosures discussed above that are specific to the debt security purchased or sold in a particular transaction, proposed Rule 2231(b)(6) would require members to notify customers of the location and availability of an NASD-authored disclosure document that discusses investing in bonds, titled "Important Information You Need to Know About Investing in Bonds."<sup>12</sup> Members would be permitted to provide customers with the NASD's internet Web site address where the disclosure document is located, or the member's own internet Web site address, provided that the disclosure document, or an internet hyperlink directly thereto, is easily accessible from the internet address that is provided to customers. Members would be required to provide a paper copy of this document upon request, but would be permitted to provide this document in electronic form (e.g., as an attachment to an e-mail) if the customer requests that it be delivered in electronic form.

NASD has prepared the proposed disclosure document because NASD believes that individual investors need more information generally regarding the purchase and sale of bonds. The information should aid an investor in determining whether a bond is an appropriate investment given the investor's investment objectives, whether the bond's price is comparable to other reported transactions in the same or a similar security, and the bond's overall risk/return. NASD describes various types of corporate bonds and

---

<sup>12</sup> See Exhibit A in Notice to Members 05-21, at 13-17.

their common features or provisions (e.g., coupon rate, face value, and maturity), as well as certain important risks that should be considered when investing in debt securities, such as interest rate risk, call and reinvestment risk, refunding risk (and sinking fund provisions), and default and credit risk (including the differences between subordinated and non-subordinated debt). The document also addresses other topics, including but not limited to bond pricing, the relationship between price and yield, and the differences between a bond's yield to maturity and its yield to call.

Exceptions. In Rule 2231, there are three significant exceptions to the general requirement that members provide supplemental disclosures to customers in connection with debt securities transactions. First, proposed Rule 2231 does not extend to transactions between a member and its institutional customers. "Institutional customer" would be defined to mean a "qualified purchaser" as defined under the Investment Company Act of 1940.<sup>13</sup> The second and third exceptions exclude transactions in

---

<sup>13</sup> The term "qualified purchaser" is defined in Section 2(a)(51) of the Investment Company Act of 1940, which provides, in pertinent part:

[A]ny natural person (including any person who holds a joint, community property, or other similar shared ownership interest in an issuer that is excepted under section 3(c)(7) [15 USCS § 80a-3(c)(7)] with that person's qualified purchaser spouse) who owns not less than \$5,000,000 in investments, as defined by the Commission ... or any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than \$25,000,000 in investments....

15 U.S.C. 80A-2(a)(51)(A)(i).

“exempted securities” as defined in Section 3(a)(12)<sup>14</sup> of the Act and “asset-backed securities” as defined in SEC Rule 10b-10.<sup>15</sup>

As noted in Item 2 of this filing, NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be not later than nine months following publication of the Notice to Members announcing Commission approval.

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. Specifically, the proposed rule change would provide investors with information with which they might better assess the quality of their executions in debt securities transactions, the fees charged and whether the security purchased fits their investment goals.

---

<sup>14</sup> 15 U.S.C. 78c(a)(12).

<sup>15</sup> Exchange Act Section 3(a)(12)’s definition of “exempted security” covers a variety of securities including government securities, municipal securities, an interest or participation in certain trust funds, pooled income funds and collective investment funds, and securities issued in connection with certain qualified plans and church plans. “Asset-backed security” is defined in Rule 10b-10(d)(10) to mean:

[A] security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the security holders.

**B. Self-Regulatory Organization's Statement on Burden on Competition**

NASD 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, as amended.

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

NASD requested comment on proposed Rule 2231, including the proposed disclosure document, in Notice to Members 05-21. NASD received eleven comment letters in response to Notice to Members 05-21. Commenters generally supported the underlying goals of the proposed rule change. One commenter stated that the proposed rule change represents an important advancement for transparency in the retail corporate debt market.

Most commenters believed that the proposed rule change would require significant operational changes and should be implemented on a delayed basis with at least a six-month delayed effective date, although certain commenters believed that the delay period should be as long as 18 months. NASD has considered members' comments carefully and believes that it is important for providing adequate notice to members to allow members to prepare operationally to provide customers additional disclosures for each debt securities transaction. At this time, NASD preliminarily has determined that, following the approval of the proposed rule change by the SEC, if obtained, the proposed rule would become effective no later than nine months following such approval.

One commenter indicated that the costs of the proposed rule change would outweigh its benefits if it does not contain a point-of-sale delivery requirement. NASD

initially considered proposing a point-of-sale delivery requirement, but after extensive deliberations that included input from relevant NASD advisory committees, NASD concluded that the costs associated with such an approach, particularly the operational burden it would impose on firms, would not, at this time, be outweighed by the incremental marginal enhancement of investor protection that NASD anticipates might be achieved, particularly when compared to the confirmation disclosure approach that has been proposed.

Certain commenters suggested that the proposed definition of “institutional investor” used in the proposed rule change would be difficult to administer on a transaction-by-transaction basis and suggested using a transaction level threshold such as \$100,000 to determine which transactions trigger the disclosure requirement (i.e., anything over \$100,000 would be excluded).

NASD carefully considered these comments, but has decided that, on balance, the proposed definition of institutional investor is a more appropriate standard given the exemptive nature of this provision. Additionally, it is NASD’s understanding, based on feedback from industry experts, that market participants generally are familiar with the application of the “Qualified Purchaser” standard as well as the related Commission and SEC staff interpretations. However, NASD agrees with the commenters that the costs and operational burdens that would be incurred in determining if a customer is an institutional customer on a transaction-by-transaction basis would be significant. In response to these comments, NASD has modified proposed Rule 2231(a)(2)(A) to make clear that members only would be required to make such a determination with regard to a particular customer once every twelve months.

Several commenters suggested that the proposed CUSIP disclosure would be sufficient and that disclosure of a debt security's TRACE symbol would not be useful to investors, and would add unnecessary costs. NASD has carefully considered these views, but believes that disclosing TRACE symbols when they exist will enhance investor understanding of corporate bond pricing because the TRACE symbols are generally alphabetical symbols and closely resemble the name of the issuer and/or the alphabetical symbols used for the issuer's equity securities, thereby allowing investors to more easily identify one or more bonds. NASD believes that the estimated positive impact on investor use and comprehension of corporate bond market data would justify the marginal cost associated with requiring such disclosures to be made.

The proposal published in Notice to Members 05-21 would have required a mandatory field labeled "brokerage charges" in which one of three specified statements would have appeared, as applicable. Commenters agreed that fees and charges involved in a transaction should be clearly disclosed to customers, but expressed concerns that as proposed, this disclosure would, in certain cases, incorrectly suggest the existence of an agency relationship. In response to these comments, NASD has proposed re-naming the "brokerage charges" field the "broker-dealer charges" field, has eliminated the proposed disclosure for agency transactions to avoid potential confusion, and has modified the text of the two remaining fields.

As initially published in Notice to Members 05-21, the proposed rule change would have required a member to disclose any credit rating of a debt security rated by a nationally recognized statistical rating organization ("NRSRO") to which the member subscribes. Some commenters sought clarification on the specific meaning of the term

“subscribes.” In response to these comments, NASD has clarified proposed Rule 2231(b)(3) by eliminating the use of the term “subscribes” and requiring that members comply with the credit rating disclosure requirement if a member or its clearing firm or service bureau providing confirmation services on that transaction has “entered into a written agreement with the NRSRO to receive such credit ratings.”

Many commenters believe that all members should be required to comply with the credit rating disclosure requirement regardless of whether they already receive such information from an NRSRO. NASD has not proposed this requirement at this time, but if the proposed rule change is approved by the Commission, NASD intends to monitor the percentage of firms that subscribe to and/or disclose NRSRO credit ratings to customers under proposed Rule 2231. If a uniform practice of disclosure of NRSRO ratings does not arise, NASD will consider the advisability of mandating at least one subscription to an NRSRO. Additionally, NASD has expanded this proposed requirement to also cover members whose clearing firm or service bureau subscribes to a credit rating service of an NRSRO. NASD believes that this provision will serve to achieve a higher degree of uniformity than if the proposed provision applied only to members who maintain such subscriptions.

Certain commenters urged NASD to permit members to provide disclosures on frequency of interest and principal payments only when an investor specifically requests them. Additionally, it was recommended that NASD allow firms to satisfy this rule in any manner that conveys the frequency of payments. NASD has determined to propose these provisions as they were published in Notice to Members 05-21. NASD carefully considered these comments and has balanced what it and the Panel perceive as the need

for investors to have this particular information with the cost imposed on members in providing this information.

Additionally, commenters generally supported the disclosure of enhanced yield information, but did raise concerns about how yield would be required to be calculated. Generally, NASD intends to defer to the Commission and SEC staff's body of interpretive guidance interpreting SEC Rule 10b-10 on such issues if relevant guidance has been issued or otherwise provided.<sup>16</sup>

Finally, the majority of commenters agreed that educational information on corporate bond investing should be available to the public, but differed as to the logistics of making such materials available. Many commenters, however, were concerned about customers suffering from securities regulatory disclosure "information overload." NASD is sensitive to these concerns, but believes that the disclosure document containing educational information strikes an appropriate balance between being concise while focusing on the major risks associated with investing in the corporate bond market.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should

---

<sup>16</sup> See supra note 9.

be 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-NASD-2005-100 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2005-100. 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 Web site (<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

inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NASD.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to the File Number SR-NASD-2005-100 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

Secretary

---

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