

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

<input type="checkbox"/> Initial	<input checked="" type="checkbox"/> Amendment	<input type="checkbox"/> Withdrawal	<input checked="" type="checkbox"/> Section 19(b)(2)	<input type="checkbox"/> Section 19(b)(3)(A)	<input type="checkbox"/> Section 19(b)(3)(B)
			Rule		
<input type="checkbox"/> Pilot	<input type="checkbox"/> Extension of Time Period for Commission Action	<input type="text" value=""/> Date Expires	<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)	

<input type="checkbox"/> Exhibit 2 Sent As Paper Document	<input type="checkbox"/> Exhibit 3 Sent As Paper Document
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Description
Provide a brief description of the proposed rule change (limit 250 characters).

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"/>
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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="12/21/2005"/>
By	<input type="text" value="Marc Menchel"/>
	(Name)
	<input type="text" value="Executive Vice President and 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

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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

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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

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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

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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

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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

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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

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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”) Amendment No. 1 to SR-NASD-2005-100, which proposes: (1) Rule 2231, requiring members, subject to specified exceptions, (a) 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 (b) to notify customers of the availability of a disclosure document discussing debt securities authored by NASD; and (2) the disclosure document.

Amendment No. 1 to SR-NASD-2005-100 replaces and supersedes in its entirety the proposed rule change as filed on August 19, 2005, except Exhibits 2a and 2b thereto. The text of the proposed rule change is set forth in Exhibit 4 hereto (marked to show changes proposed in this Amendment No. 1) and Exhibit 5 hereto.

(b) Not applicable.

(c) Not applicable.

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 would 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 would 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

Rule Filing History

On August 19, 2005, NASD filed SR-NASD-2005-100, a proposed rule change to adopt proposed Rule 2231 and a proposed disclosure document discussing debt securities, with the Commission. Proposed Rule 2231 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 to notify customers of the availability of a disclosure document discussing debt securities authored by NASD. The proposed disclosure document discusses various types of corporate bonds, certain risks of investing in such bonds, and other, related issues. Based on comments from SEC staff, NASD is restating the proposed rule change and incorporating certain administrative, technical, or clarifying amendments to the proposed rule change in this Amendment No. 1.

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.¹ 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. NASD also believes that the proposed rule change will further efficiency, competition, and capital formation in the market for corporate debt securities. NASD anticipates that the proposed rule change, by providing greater transparency to debt securities transactions, will result in greater efficiency in pricing and further competition in the market for corporate debt securities. NASD believes the proposed rule change also will enhance capital formation to the extent that investors are better able to assess the risks and benefits related to investing in corporate debt securities.

¹ See NASD Notice to Members 05-21 (April 2005); see also Report of the Corporate Debt Market Panel, September 2004, http://www.nasd.com/web/groups/reg_systems/documents/regulatory_systems/nasdw_011445.pdf (“Panel Report”) (containing the findings and recommendations of the Corporate Debt Market Panel (“Panel”). The Panel reviewed information showing significant levels of participation by individual investors in the corporate bond market. For example, 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. The Panel also reviewed 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. Panel Report at 4.

The proposed rule change is based upon issues raised and recommendations developed by the 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.² 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-10,³ 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.⁴ Proposed Rule 2231 also would require members to notify customers of the

² See generally Panel Report.

³ 17 CFR 240.10b-10.

⁴ 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. For example, the

availability of a disclosure document discussing debt securities authored by NASD.⁵ 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, because NASD believes such requirements could be unwieldy without materially enhancing investor protection.

The specific additional disclosures would include the CUSIP,⁶ and the TRACE symbol, if available, to assure that the transaction is identified as clearly as possible. A

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, SEC No-Action Letter, 1999 SEC No-Act Lexis 934 (August 23, 1999) (SEC’s Division of Market Regulation grants industry-wide exemptive relief on behalf of the Commission pursuant to delegated authority). NASD 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. If the SEC approves the proposed Rule, NASD would provide guidance in this area only in instances where the SEC or its staff has not already addressed a particular issue.

⁵ For purposes of proposed Rule 2231, “debt security” is defined to have the same meaning it has under SEC Rule 10b-10, subject to the exceptions specified in the proposed Rule.

⁶ Proposed Rule 2231(b). “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

member would be required to select and disclose, if applicable, a statement relating to transaction charges (i.e., a mark-up, mark-down, “spread,” fee, or a combination of the preceding).⁷ These standard disclosures are intended to clarify for investors dealing with a member acting as a principal, in the capacity of either a dealer or market maker, whether a member has obtained any remuneration in connection with the customer’s debt securities transaction. The credit rating of the security and the Nationally Recognized Statistical Rating Organization (“NRSRO”) assigning it the rating, would be required to be disclosed.⁸ 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.⁹ A member also would be required to disclose whether transaction price

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.

⁷ Proposed Rule 2231(b)(2). NASD is not proposing to require that the amount of the member’s mark-up or mark-down be disclosed, since, under SEC Rule 10b-10, agency commissions are required to be disclosed, but a principal’s mark-up or mark-down is not.

⁸ Proposed Rule 2231(b)(3).

⁹ 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. NASD noted in Notice to Members 05-21 that, if the proposed Rule were adopted, NASD would monitor the percentage of firms that subscribe to and disclose NRSRO ratings and would consider the advisability of mandating at least one subscription to an NRSRO if a uniform practice of disclosing NRSRO ratings did not arise. For example, NASD might consider such an approach if the proposed Rule were adopted and NASD became aware that member firms were

information is publicly available for the security and if it is, that a customer may, if the debt security is a TRACE-eligible security, obtain such information at the NASD internet web site www.nasdbondinfo.com for the customer's non-commercial use at no charge, or at other sources that provide such information.¹⁰

For customer purchases only, members would be required to provide the frequency of interest and principal payments and 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.¹¹ For variable rate debt securities, the member would be required to inform the customer that the coupon rate may vary and that the member will provide additional information in writing about the variable debt upon the customer's request.¹² Finally, when a member sells to a customer a debt security that is callable and, at issue, is not structured to include scheduled interest payments (e.g., "zero coupon bonds"), the member would be required to provide the dollar equivalent of the debt security's imputed interest until the next

seeking to avoid disclosing NRSRO ratings by paying their clearing firms or service bureaus a separate, nominal charge to receive such ratings to circumvent the requirement in proposed Rule 2231(b)(3)(B) and (C) that requires a member to make such disclosures only if the member receives NRSRO ratings from its clearing firm "at no additional cost." Finally, a member that receives credit rating information and whose clearing firm also receives credit rating information would be permitted to choose which credit ratings to disclose.

¹⁰ Proposed Rule 2231(b)(4).

¹¹ Proposed Rule 2231(b)(5).

¹² Proposed Rule 2231(b)(5)(C).

occurring call date (assuming that the price at which the debt security may be called is paid to the holder).¹³

Proposed Disclosure Document

Members would be required 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.”¹⁴

Exceptions

The proposed Rule contains 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.¹⁵ The second and third

¹³ Proposed Rule 2231(b)(5)(D).

¹⁴ The proposed disclosure document describes various types of corporate bonds and their common features or provisions (e.g., coupon rate, face value, and maturity), as well as risks investors should consider before 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 bond pricing, the relationship between price and yield, and the difference between a bond’s yield to maturity and its yield to call. NASD believes the proposed disclosure document should aid investors in determining whether a bond is an appropriate investment given the investor’s investment objectives. Members would be permitted to provide customers with the NASD’s internet web site address where this disclosure document is located, or the member’s own internet web site address, provided that this 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 disclosure document upon request, but would be permitted to provide this disclosure document in electronic form (e.g., as an attachment to an e-mail) if the customer requests that it be delivered in electronic form.

¹⁵ “Institutional customer” would be defined to mean a “qualified purchaser” as defined under the Investment Company Act of 1940. The term “qualified

exceptions exclude transactions in “exempted securities” as defined in Section 3(a)(12)¹⁶ of the Act and “asset-backed securities” as defined in SEC Rule 10b-10.¹⁷

As noted in Item 2 of this filing, NASD would 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. As proposed, the effective date would not be later than nine months following publication of the Notice to Members announcing Commission approval.

(b) Statutory Basis

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).

¹⁶ 15 U.S.C. 78c(a)(12).

¹⁷ 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.

NASD believes that the proposed rule change is consistent with the provisions of Section 15A of the Act in general, and Section 15(A)(b)(6) of the Act in particular, which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and to perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

NASD believes that the proposed rule change is consistent with these requirements in that it 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 comments on proposed Rule 2231 and 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. Certain commenters expressed concern about various aspects of the proposed rule change such as whether the costs that would be imposed on members by the proposed rule and the proposed disclosure document would be justified by the benefits that would accrue to customers. 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 change would become effective no later than nine months following the issuance of a Notice to Members announcing such approval (which Notice would be issued within 60 days of 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 an 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.¹⁸

¹⁸ See, supra, n. 4.

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. 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.

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 1a. NASD's statement on comments on the proposed rule change received from members, participants, or others.

Exhibit 4. Shows the full text of the proposed rule change marked to show changes from the text of Rule 2231 and the disclosure document as proposed on August 19, 2005, in the original rule filing, SR-NASD-2005-100, to this Amendment No. 1, with the text in the original rule filing shown as if adopted, and the new text marked to show additions and deletions.

Exhibit 5. Complete text of proposed Rule 2231 and the proposed disclosure document.

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”)¹ and Rule
19b-4 thereunder,² 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. On December
XX, 2005, NASD filed Amendment No. 1 to the proposed rule change.³ 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: (1) Rule 2231, requiring members, subject to
specified exceptions, (a) to provide customers in debt securities transactions additional,
transaction-specific disclosures relating to applicable charges and fees, credit ratings, the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 to SR-NASD-2005-100 replaces and supersedes in its entirety
the proposed rule change as filed on August 19, 2005, except Exhibits 2a and 2b
thereto.

availability of last-sale transaction information, and certain interest, yield and call provisions; and (b) to notify customers of the availability of a disclosure document discussing debt securities authored by NASD; and (2) the disclosure document. The text of the proposed rule change is set forth in Exhibit 4 and Exhibit 5 to Amendment No. 1 to SR-NASD-2005-100 (Exhibit 4 is marked to show changes proposed in Amendment No. 1).

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

Rule Filing History

On August 19, 2005, NASD filed SR-NASD-2005-100, a proposed rule change to adopt proposed Rule 2231 and a proposed disclosure document discussing debt securities, with the Commission. Proposed Rule 2231 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 to notify customers of the availability of a disclosure document discussing debt securities

authored by NASD. The proposed disclosure document discusses various types of corporate bonds, certain risks of investing in such bonds, and other, related issues. Based on comments from SEC staff, NASD is restating the proposed rule change and incorporating certain administrative, technical, or clarifying amendments to the proposed rule change in this Amendment No. 1.

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.⁴ 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

⁴ See NASD Notice to Members 05-21 (April 2005); see also Report of the Corporate Debt Market Panel, September 2004, http://www.nasd.com/web/groups/reg_systems/documents/regulatory_systems/nasdw_011445.pdf ("Panel Report") (containing the findings and recommendations of the Corporate Debt Market Panel ("Panel")). The Panel reviewed information showing significant levels of participation by individual investors in the corporate bond market. For example, 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. The Panel also reviewed 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. Panel Report at 4.

transparency in the corporate debt market. NASD also believes that the proposed rule change will further efficiency, competition, and capital formation in the market for corporate debt securities. NASD anticipates that the proposed rule change, by providing greater transparency to debt securities transactions, will result in greater efficiency in pricing and further competition in the market for corporate debt securities. NASD believes the proposed rule change also will enhance capital formation to the extent that investors are better able to assess the risks and benefits related to investing in corporate debt securities.

The proposed rule change is based upon issues raised and recommendations developed by the 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.⁵ 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

⁵ See generally Panel Report.

provide information to the customer pursuant to SEC Rule 10b-10,⁶ 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.⁷ Proposed Rule 2231 also would require members to notify customers of the availability of a disclosure document discussing debt securities authored by NASD.⁸ 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

⁶ 17 CFR 240.10b-10.

⁷ 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. 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, SEC No-Action Letter, 1999 SEC No-Act Lexis 934 (August 23, 1999) (SEC’s Division of Market Regulation grants industry-wide exemptive relief on behalf of the Commission pursuant to delegated authority). NASD 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. If the SEC approves the proposed Rule, NASD would provide guidance in this area only in instances where the SEC or its staff has not already addressed a particular issue.

⁸ For purposes of proposed Rule 2231, “debt security” is defined to have the same meaning it has under SEC Rule 10b-10, subject to the exceptions specified in the proposed Rule.

10b-10 confirmation, because NASD believes such requirements could be unwieldy without materially enhancing investor protection.

The specific additional disclosures would include the CUSIP,⁹ and the TRACE symbol, if available, to assure that the transaction is identified as clearly as possible. A member would be required to select and disclose, if applicable, a statement relating to transaction charges (i.e., a mark-up, mark-down, “spread,” fee, or a combination of the preceding).¹⁰ These standard disclosures are intended to clarify for investors dealing with a member acting as a principal in the capacity of either a dealer or market maker, whether a member has obtained any remuneration in connection with the customer’s debt securities transaction. The credit rating of the security and the Nationally Recognized Statistical Rating Organization (“NRSRO”) assigning it the rating, would be required to be disclosed.¹¹ 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 rating agency to receive such

⁹ Proposed Rule 2231(b). “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.

¹⁰ Proposed Rule 2231(b)(2). NASD is not proposing to require that the amount of the member’s mark-up or mark-down be disclosed, since, under SEC Rule 10b-10, agency commissions are required to be disclosed, but a principal’s mark-up or mark-down is not.

¹¹ Proposed Rule 2231(b)(3).

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.¹² A member also would be required to disclose whether transaction price information is publicly available for the security and if it is, that a customer may, if the debt security is a TRACE-eligible security, obtain such information at the NASD internet web site www.nasdbondinfo.com for the customer's non-commercial use at no charge, or at other sources that provide such information.¹³

For customer purchases only, members would be required to provide the frequency of interest and principal payments and 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.¹⁴ For variable rate debt securities, the member would be required to inform the customer that the coupon rate may vary and that the member will provide additional information in writing about

¹² 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. NASD noted in Notice to Members 05-21 that, if the proposed Rule were adopted, NASD would monitor the percentage of firms that subscribe to and disclose NRSRO ratings and would consider the advisability of mandating at least one subscription to an NRSRO if a uniform practice of disclosing NRSRO ratings did not arise. For example, NASD might consider such an approach if the proposed Rule were adopted and NASD became aware that member firms were seeking to avoid disclosing NRSRO ratings by paying their clearing firms or service bureaus a separate, nominal charge to receive such ratings to circumvent the requirement in proposed Rule 2231(b)(3)(B) and (C) that requires a member to make such disclosures only if the member receives NRSRO ratings from its clearing firm "at no additional cost." Finally, a member that receives credit rating information and whose clearing firm also receives credit rating information would be permitted to choose which credit ratings to disclose.

¹³ Proposed Rule 2231(b)(4).

¹⁴ Proposed Rule 2231(b)(5).

the variable debt upon the customer's request.¹⁵ Finally, when a member sells to a customer a debt security that is callable and, at issue, is not structured to include scheduled interest payments (e.g., "zero coupon bonds"), the member would be required to provide 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).¹⁶

Proposed Disclosure Document

Members would be required 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."¹⁷

¹⁵ Proposed Rule 2231(b)(5)(C).

¹⁶ Proposed Rule 2231(b)(5)(D).

¹⁷ The proposed disclosure document describes various types of corporate bonds and their common features or provisions (e.g., coupon rate, face value, and maturity), as well as risks investors should consider before 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 bond pricing, the relationship between price and yield, and the difference between a bond's yield to maturity and its yield to call. NASD believes the proposed disclosure document should aid investors in determining whether a bond is an appropriate investment given the investor's investment objectives. Members would be permitted to provide customers with the NASD's internet web site address where this disclosure document is located, or the member's own internet web site address, provided that this 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 disclosure document upon request, but would be permitted to provide this disclosure document in electronic form (e.g., as an attachment to an e-mail) if the customer requests that it be delivered in electronic form.

Exceptions

The proposed Rule contains 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.¹⁸ The second and third exceptions exclude transactions in “exempted securities” as defined in Section 3(a)(12)¹⁹ of the Act and “asset-backed securities” as defined in SEC Rule 10b-10.²⁰

¹⁸ “Institutional customer” would be defined to mean a “qualified purchaser” as defined under the Investment Company Act of 1940. 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).

¹⁹ 15 U.S.C. 78c(a)(12).

²⁰ 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.

NASD would 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. As proposed, the effective date would not be 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 of the Act in general, and Section 15(A)(b)(6) of the Act in particular, which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and to perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

NASD believes that the proposed rule change is consistent with these requirements in that it 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.

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's statement on comments received from members, participants, or others is set forth in Exhibit 1a to Amendment No. 1 to SR-NASD-2005-100.

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 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. 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.²¹

Secretary

²¹ 17 CFR 200.30-3(a)(12).

**NASD's Statement on Comments on the Proposed
Rule Change Received from Members, Participants, or Others**

NASD requested comments on proposed Rule 2231 and the proposed disclosure document in NASD 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. Certain commenters expressed concern about various aspects of the proposed rule change such as whether the costs that would be imposed on members by the proposed rule and the proposed disclosure document would be justified by the benefits that would accrue to customers. 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 change would become effective no later than nine months following the issuance of a

Notice to Members announcing such approval (which Notice would be issued within 60 days of 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 Securities Exchange Commission (“SEC” or “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 Panel¹ 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.²

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. NASD has prepared the proposed disclosure document because NASD believes that

¹ See generally Amendment No. 1 to SR-NASD-2005-100, Exhibit 1.

² See Amendment No. 1 to SR-NASD-2005-100, Exhibit 1, n.7.

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.

**Exhibit 4
Amendment No. 1 to
SR-NASD-2005-100**

Exhibit 4 shows the full text of the proposed rule change marked to show changes from the text of Rule 2231 and the disclosure document as proposed on August 19, 2005, in the original rule filing, SR-NASD-2005-100, to this Amendment No. 1, with the text in the original rule filing shown as if adopted, and the new text marked to show additions and deletions.

Text of proposed Rule 2231 and the proposed disclosure document added in this Amendment No. 1 is underlined, and proposed deletions are bracketed.

* * * * *

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.* [D] A member must 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.* A member must [D]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) of the debt security the member purchased for or from or sold to or for a customer, 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.* A member must [D]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 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, a member must 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, a statement [disclosure] indicating that the coupon rate may vary and that the member

will provide in writing additional information that describes the way in which [relating to the calculation of]the debt security's interest and principal payments are calculated 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, a member must disclose 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. 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.

* * * * *

Important Information You Need to Know about Investing in Corporate Bonds

This document is intended to provide you with some basic facts about the most common features of corporate bonds, and to alert you to some of the risks associated with buying, selling, and holding corporate bonds.

As with any investment, before buying a corporate bond, you should analyze the bond on its own merits, weighing its risks, costs, and rewards. Consult with your firm about any questions you may have about investing in a particular bond.

Corporate Bond Basics

What is a corporate bond?

Corporate bonds are, at their simplest, loans that investors make to public and private corporations. Consequently, bonds are referred to as debt securities. Corporations generally issue corporate bonds to raise money for capital expenditures, operations, and acquisitions.

Typically, bondholders receive interest payments during the term of a bond (or, for as long as a bondholder owns a bond), at the stated interest rate—also called the coupon rate. In addition, if bondholders hold bonds until maturity, they also are repaid the principal amount, called par value or face amount.

Bond Price and Yield

Price

If you sell a bond before it matures, you may not receive the full principal amount of the bond. This is because a bond's price is not based on the par value of the bond. Rather, it is set in the secondary market and is established by the current market values of such bonds, which may be more or less than the amount of principal the issuer would be required to pay the bondholder at maturity. Therefore, it is impossible to predict in advance the price that a bondholder will receive if the bondholder purchases a bond and later sells the bond before maturity.

The price of a bond is often above or below its par value because the price is adjusted according to current interest rates in the whole market for the same debt security and comparable debt securities. For example, if the bond you desire to purchase has a fixed interest rate of 8 percent, and similar quality new bonds available for sale have a fixed interest rate of 5 percent, you will have to pay more than the par amount of the bond that you intend to purchase, because you will receive more interest income than the current interest rate (5 percent) being attached to similar bonds.

Yield

Yield is the overall return on the capital you invest in the bond. Yield is similar to, but different from, a bond's interest rate. This distinction is important, because as is explained above, while a bond's face amount or par value is fixed, its market value almost always changes over time. Because bond prices fluctuate continually in the

market, the yield your bond investment will provide if it is sold prior to maturity also changes constantly. *A bond's price is inversely related to its yield. As a bond's price increases, its associated yield decreases; as the price of a bond decreases, the associated yield increases.*

For example, a bond that sells today for \$1,000 and has a coupon rate of 8 percent has a current yield of 8 percent. Because the “price” equals the face amount of the bond, the current yield of 8 percent equals the 8 percent fixed interest rate. However, usually after the first sale of a bond, the price of a bond differs from the face amount. For example, if the same bond sells tomorrow for \$990, the current yield would be slightly higher than 8 percent.

Yield to maturity and yield to call: What's the difference?

Yield to maturity is calculated by taking into account the total amount of interest you will receive over time, your purchase price (the amount of capital you invested), the face amount (or other amount you will be paid when the issuer “redeems” the bond), the time between interest payments, and the time remaining until the bond matures.

If you hold a callable bond, another type of yield calculation, yield to call, also is important for you to understand. This calculation takes into account the impact on a bond's yield if it is called prior to maturity and is often done using the first date on which the issuer could call the bond. (Other call dates may be used in specified circumstances.) A bond's yield to call may be lower than its yield to maturity.

To get a more accurate picture of what a bond will cost you or what you received for it, you should also ask your broker to calculate the yield adjusting the purchase price up (when you purchase) or down (when you sell) by the amount of the mark-up or commission (when you purchase) or mark-down or commission (when you sell) and other fees or charges that you are charged by your broker for its services. This is called yield reflecting broker compensation.

Corporate Bond Risks

Like virtually all investments, corporate bonds carry risk. It is important that you fully understand the risks of investing in corporate bonds. These risks include:

Interest Rate Risk

When interest rates rise, bond prices fall, and when interest rates fall, bond prices rise. Interest rate risk is the risk that changes in interest rates generally in the U.S. or the world economy may reduce (or increase) the market value of a bond you hold. Interest rate risk increases the longer that you hold a bond. For example, if interest rates rise throughout the economy, bond issuers, along with other borrowers, will need to offer potential bondholders higher rates to compete with the higher interest rates available elsewhere.

Any bonds issued in a period of rising interest rates generally will carry higher coupon rates, which will be more attractive to potential bondholders than the coupon rate paid by bonds issued before the rise in interest rates. This decreased appetite for older bonds that pay lower interest depresses their price in the secondary market, which would translate into your receiving a lower price for your bonds if you chose to resell them in a period of

rising interest rates. The opposite holds true as well, and the market value of older bonds that pay higher than current interest rates tends to rise in periods where interest rates are generally declining.

Call and Reinvestment Risk

Bonds with a call provision can be redeemed or “called” by the bond issuers, requiring bondholders to redeem their bonds at the call price well before their maturity dates.

Bonds often are called when market interest rates are falling, because bond issuers want to refinance their debt at lower interest rates (similar to when a home owner seeks to refinance a mortgage at a lower rate when mortgage interest rates decrease). This is known as call risk.

With a callable bond, a bondholder might not receive the bond’s coupon rate for the entire term of the bond, and it might be difficult or impossible to find an equivalent investment paying rates as high as the called bond. This is known as reinvestment risk.

Additionally, at any given point in time, the stream of a callable bond’s cash flow is uncertain and any appreciation in the market value of the bond may not rise.

Refunding Risk and Sinking Funds Provisions

A sinking fund provision, which often is a term included in bonds issued by industrial and utility companies, requires a bond’s issuer to retire a certain number of bonds periodically. This can be accomplished in a variety of ways, including through purchases in the secondary market or forced purchases directly from bondholders at a pre-determined price.

Holders of bonds subject to sinking fund redemptions should understand that they risk having their bonds called (or redeemed) prior to maturity. Unlike other bonds subject to call, depending on the sinking fund provision, there may be a relatively high likelihood that the issuer will be able to redeem some or many of the bonds prior to maturity, even if market-wide interest rates do not change.

It is important to understand that there is no guarantee that an issuer of these bonds will be able to comply strictly with any redemption requirements. In certain cases, an issuer may need to borrow funds or issue additional debt to refinance an outstanding bond issue subject to a sinking fund provision when it matures. If the issuer is unable to raise adequate funds to refinance the outstanding issue, the bondholder may be faced with an issuer default and potential loss of principal.

Default and Credit Risk

If you ever loaned money to someone, chances are you gave some thought to the likelihood of being repaid. Some loans are riskier than others. The same is true when you invest in bonds. You are taking a risk that the issuer's promise to repay both principal and interest will be upheld. In the case of Treasuries and other government-issued bonds backed by the "full faith and credit of the U.S. government," that risk is almost zero. However, with most corporate bonds there is some risk of default. This means the corporations issuing them may either be late paying bondholders or—in worst-case scenarios—be unable to pay at all.

Bond ratings are a way of measuring default and credit risk. [Five ratings agencies have been designated by the staff of the Securities and Exchange Commission to be a

Nationally Recognized Statistical Rating Organization. They are A. M. Best, Dominion, Fitch, Moody's, and Standard & Poor's. These organizations review all information known about the issuer, especially all financial information, such as the issuer's financial statements and assign a rating—AAA (or Aaa) to D.] Five credit ratings agencies have received no-action relief from the Commission staff for broker-dealers to consider the credit rating agency as a Nationally Recognized Statistical Rating Organization for purposes of the net capital rule, Rule 15c3-1 of the Securities Exchange Act of 1934: A.M. Best Company, Inc., Dominion Bond Rating Service Limited, Fitch, Inc., Moody's Inc., and the Standard & Poor's Division of the McGraw Hill Companies, Inc. In issuing a credit rating these organizations review relevant information supplied to them by the issuer or its agents, and from sources it considers reliable, including financial information such as the issuer's financial statements and assigns a rating (for example AAA or Aaa to D).

Generally, bonds are categorized in two broad categories—investment grade and non-investment grade. Bonds that are rated BBB (or Baa) or higher are considered investment grade. Bonds that are rated BB (or Ba) or lower are non-investment grade. Non-investment grade bonds are also referred to as high-yield or junk bonds, and in some cases, distressed bonds. These bonds are considered riskier investments because the issuer's general financial condition is less sound, and the issuer may default—(may not be able to pay the interest and principal to bondholders when they are due).

Many bondholders heavily weigh the rating of a particular corporate bond in determining if the corporate bond is an appropriate and suitable investment for them. Although credit ratings are an important indicator of creditworthiness, you should also consider that the

value of the bond might change depending on changes in the company's business and profitability. The credit rating could be revised downward. In the worst scenario, if you own a bond and the company that issues it defaults you could lose all of your investment. [corporate bankruptcy, holders of corporate bonds could suffer significant losses, including the loss of their entire investment.] Finally, some bonds are not rated. In such cases, an individual bondholder may find it difficult to assess the overall creditworthiness of the issuer of the bond.

Liquidity Risk

You should determine whether the bond in which you are interested has traded frequently, infrequently, or not at all in recent months, and if your broker regularly buys and sells the bond. While certain bonds are very actively traded and are relatively "liquid," other bonds, including many high-yield bonds, are traded much less frequently or not at all and may not be easy to sell. If you think you might need to sell the bonds you are purchasing prior to their maturity, you should carefully consider the likelihood of your being able to do so, and whether your broker will be able and willing to assist you in liquidating your investment at a fair price reasonably related to then current market prices. It is possible that you may be able to re-sell a bond *only* at a heavy discount to the price you paid (loss of some principal) or not at all. Additionally, bonds that are less frequently traded may be subject to wider "spreads" in the secondary market, which means that you would receive less for your bond if selling, or pay more if buying, than otherwise would be the case.

Corporate Bonds with Special Features

It also is important to understand any special features a bond may have before you buy, since these features may affect risk.

Floating Rate Bonds

Floating-rate bonds have a floating or variable interest rate that is adjusted periodically, or floats, using an external value or measure (for example, the prime rate or a stock index). Such bonds offer protection against interest rate risk, but their coupon rate is usually lower than those of fixed-rate bonds.

Zero-Coupon Bonds

Zero-coupon bonds, unlike other bonds, don't make regular interest payments. Instead, the bondholder buys the bond at a discount from the face value of the bond, and, when the bond matures, the issuer repays the bondholder the face amount. The difference between the discounted amount the bondholder pays upon purchase and the face amount later received is the imputed interest. Because zero-coupon bonds don't pay any interest until maturity, their prices may be more volatile than other bonds with similar maturities that pay interest periodically.

Secured Bonds

Secured bonds are backed by collateral that the bond's issuer has agreed to sell if it otherwise is unable to meet its obligation when the bond matures. For example, a bond might be backed by a specific factory or industrial equipment. However, any such

backing is only as good as the value of the asset being used as collateral, the value of which can decrease during the term of the bond.

Bonds that are not backed by any collateral are unsecured and are sometimes called debentures. Debentures are backed solely by an issuer's promise to repay you. Most corporate bonds are debentures.

Guaranteed and Insured Bonds

Certain bonds may be referred to as guaranteed or insured. This means that a third party has agreed to make the bond's interest and principal payments if the issuer is unable to make these payments. You should keep in mind that such guarantees only are as valuable as the creditworthiness of the third party making the guarantee or providing the insurance.

Convertible Bonds

Convertible bonds may be converted into the stock of the bond's issuer. A bondholder should be careful to understand the conditions under which the bonds may be converted, as this right often is contingent upon the issuer's stock reaching a certain price level, among other things. Bond investors also should ask their broker or financial adviser whether there is any charge or fee associated with making a conversion.

Junior or Subordinated Bonds

The more junior bonds issued by a company typically are referred to as subordinated debt, because a junior bondholder's claim for repayment of the principal of such bonds is

subordinated to the claims of bondholders holding the issuer's more senior debt. Additionally, other types of claims also may have priority on the issuer's remaining assets over the claims of *all* bondholders (e.g., certain supplier or customer claims). Therefore, although bondholders generally are paid prior to stockholders in a bankruptcy proceeding, this doesn't mean the bondholder will get any money back because [this may offer little comfort if]the issuer's assets could be [are]reduced to zero by other creditors that have the right to be paid before bondholders of a particular class of bonds.

Broker Compensation for Selling Bonds

No commission does not mean no charge.

You should understand that your broker is being compensated for performing services for you, even if you are not charged a commission when you buy or sell a bond. In most bond transactions, brokers are compensated, even though a commission charge is not disclosed, because the transaction is structured as a principal transaction (i.e., your broker sells you a bond it already owns). This is because when a dealer sells you a bond in a principal capacity, the dealer increases or marks up the price you pay over the price the dealer paid to acquire the bond. The mark-up is the dealer's compensation and is similar to a commission. Similarly, if you sell a bond, a dealer will offer you a price that includes a mark-down from the price that the dealer believes he can sell the bond to another dealer or another buyer. [Although the broker is not required under the federal securities laws or NASD rules to disclose the amount of the broker's mark-up or mark-down, y]You should understand that the firm has charged you a fee for its services.

[Would a similar bond cost less?]

[Finally, it is important to consider the potential conflict of interest presented by the payments made to your broker. Bonds issued by different issuers often have very similar risk profiles and carry similar coupon rates. You should consider whether there are other bonds available with similar risk/return profiles that might be available at lower cost. You also should strive to understand how your broker is being compensated for any bond transaction, particularly those that are recommended to you where similar bonds may be available.]

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. A member must 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.

(2) Broker-dealer charges. A member must 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) of the debt security the member purchased for or from or sold to or for a customer, 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. A member must 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 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, a member must 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, a statement indicating that the coupon rate may vary and that the member will provide in writing additional information that describes the way in which the debt security's interest and principal payments are calculated 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 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, a member must disclose the following statement 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. 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.

* * * * *

Important Information You Need to Know about Investing in Corporate Bonds

This document is intended to provide you with some basic facts about the most common features of corporate bonds, and to alert you to some of the risks associated with buying, selling, and holding corporate bonds.

As with any investment, before buying a corporate bond, you should analyze the bond on its own merits, weighing its risks, costs, and rewards. Consult with your firm about any questions you may have about investing in a particular bond.

Corporate Bond Basics

What is a corporate bond?

Corporate bonds are, at their simplest, loans that investors make to public and private corporations. Consequently, bonds are referred to as debt securities. Corporations generally issue corporate bonds to raise money for capital expenditures, operations, and acquisitions.

Typically, bondholders receive interest payments during the term of a bond (or, for as long as a bondholder owns a bond), at the stated interest rate—also called the coupon rate. In addition, if bondholders hold bonds until maturity, they also are repaid the principal amount, called par value or face amount.

Bond Price and Yield

Price

If you sell a bond before it matures, you may not receive the full principal amount of the bond. This is because a bond's price is not based on the par value of the bond. Rather, it is set in the secondary market and is established by the current market values of such bonds, which may be more or less than the amount of principal the issuer would be required to pay the bondholder at maturity. Therefore, it is impossible to predict in advance the price that a bondholder will receive if the bondholder purchases a bond and later sells the bond before maturity.

The price of a bond is often above or below its par value because the price is adjusted according to current interest rates in the whole market for the same debt security and comparable debt securities. For example, if the bond you desire to purchase has a fixed interest rate of 8 percent, and similar quality new bonds available for sale have a fixed interest rate of 5 percent, you will have to pay more than the par amount of the bond that you intend to purchase, because you will receive more interest income than the current interest rate (5 percent) being attached to similar bonds.

Yield

Yield is the overall return on the capital you invest in the bond. Yield is similar to, but different from, a bond's interest rate. This distinction is important, because as is explained above, while a bond's face amount or par value is fixed, its market value almost always changes over time. Because bond prices fluctuate continually in the

market, the yield your bond investment will provide if it is sold prior to maturity also changes constantly. A bond's price is inversely related to its yield. As a bond's price increases, its associated yield decreases; as the price of a bond decreases, the associated yield increases.

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Yield to maturity and yield to call: What's the difference?

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Bond ratings are a way of measuring default and credit risk. Five credit ratings agencies have received no-action relief from the Commission staff for broker-dealers to consider

the credit rating agency as a Nationally Recognized Statistical Rating Organization for purposes of the net capital rule, Rule 15c3-1 of the Securities Exchange Act of 1934: A.M. Best Company, Inc., Dominion Bond Rating Service Limited, Fitch, Inc., Moody's Inc., and the Standard & Poor's Division of the McGraw Hill Companies, Inc. In issuing a credit rating these organizations review relevant information supplied to them by the issuer or its agents, and from sources it considers reliable, including financial information such as the issuer's financial statements and assigns a rating (for example AAA or Aaa to D).

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Bonds that are not backed by any collateral are unsecured and are sometimes called debentures. Debentures are backed solely by an issuer's promise to repay you. Most corporate bonds are debentures.

Guaranteed and Insured Bonds

Certain bonds may be referred to as guaranteed or insured. This means that a third party has agreed to make the bond's interest and principal payments if the issuer is unable to make these payments. You should keep in mind that such guarantees only are as valuable as the creditworthiness of the third party making the guarantee or providing the insurance.

Convertible Bonds

Convertible bonds may be converted into the stock of the bond's issuer. A bondholder should be careful to understand the conditions under which the bonds may be converted, as this right often is contingent upon the issuer's stock reaching a certain price level, among other things. Bond investors also should ask their broker or financial adviser whether there is any charge or fee associated with making a conversion.

Junior or Subordinated Bonds

The more junior bonds issued by a company typically are referred to as subordinated debt, because a junior bondholder's claim for repayment of the principal of such bonds is subordinated to the claims of bondholders holding the issuer's more senior debt.

Additionally, other types of claims also may have priority on the issuer's remaining assets over the claims of *all* bondholders (e.g., certain supplier or customer claims).

Therefore, although bondholders generally are paid prior to stockholders in a bankruptcy proceeding, this doesn't mean the bondholder will get any money back because the

issuer's assets could be reduced to zero by other creditors that have the right to be paid before bondholders of a particular class of bonds.

Broker Compensation for Selling Bonds

No commission does not mean no charge.

You should understand that your broker is being compensated for performing services for you, even if you are not charged a commission when you buy or sell a bond. In most bond transactions, brokers are compensated, even though a commission charge is not disclosed, because the transaction is structured as a principal transaction (i.e., your broker sells you a bond it already owns). This is because when a dealer sells you a bond in a principal capacity, the dealer increases or marks up the price you pay over the price the dealer paid to acquire the bond. The mark-up is the dealer's compensation and is similar to a commission. Similarly, if you sell a bond, a dealer will offer you a price that includes a mark-down from the price that the dealer believes he can sell the bond to another dealer or another buyer. You should understand that the firm has charged you a fee for its services.