

Direct: 202-728-8290
Facsimile: 202-728-8321

BY HAND

October 27, 1999

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

**Re: SR-NASD-99-65
Creation of Corporate Bond Trade Reporting Facility**

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed herewith is the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Word 7.0 to facilitate production of the Federal Register. This rule filing is being made in coordination with NASD's proposed rule change to establish mandatory trade reporting for PORTAL securities filed this same date in NASD SR-NASD-99-66.

If you have any questions, please contact Thomas P. Moran, Office of General Counsel, The Nasdaq Stock Market, Inc., at (202) 728-8401. The fax number of the Office of General Counsel is (202) 728-8321.

Very truly yours,

Robert E. Aber
Senior Vice President and General Counsel

Attachment

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD” or “Association”) is filing a series of rule changes to create a corporate bond trade reporting and transaction dissemination facility as well as eliminate the Nasdaq Stock Market Inc.'s (“Nasdaq”) Fixed Income Pricing Service (“FIPS”). Attached as Appendix I to this filing is the text of these proposed rule changes.

Proposed new language is underlined; proposed deletions are in brackets.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of Nasdaq at its meeting on July 28, 1999 and was approved by the Board of Governors of the NASD at its meeting on July 29, 1999, which authorized the filing of the rule change with the SEC. The staff of Nasdaq has provided an opportunity for the staff of NASD Regulation, Inc. to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries. No other action by the NASD is necessary for the filing of the rule change. The NASD will make the proposed rule changes effective pursuant to the schedule outlined in this filing. Questions regarding this rule filing may be directed to Robert E. Aber, Senior Vice President and General Counsel, at (202) 728-8290, Thomas P. Moran, Assistant General Counsel, at (202) 728-8401.

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

The NASD is proposing to establish a mandatory trade reporting, dissemination and comparison facility for corporate bonds. Under the proposal, beginning in the spring of the year 2000, NASD members would be obligated, for regulatory purposes, to trade report to Nasdaq's Trade

Reporting And Comparison Entry Service ("TRACESM") all secondary transactions in specified U.S. corporate bonds within 1 hour of trade execution. After an initial 6 month period for an information integrity review, Nasdaq will in turn disseminate trade reports to the public through market data vendors. Under the proposal, the initial 1 hour maximum trade reporting time frame will be subsequently reduced to 15 minutes six months after corporate bond trade reporting begins. Simultaneously with the effectiveness of the new rules governing corporate bond trade reporting, the NASD will also eliminate Nasdaq's FIPS system and its related rules.

I. Background

Early in 1998, the Securities and Exchange Commission ("SEC") began reviewing the debt markets in the United States with a particular emphasis on price transparency. This review concluded that in the area of corporate bonds, transparency was lacking and needed improvement. Subsequently, the Chairman of the SEC again highlighted the problem of the lack of transparency in the corporate bond market and called on the NASD to take the following actions:

First, adopt rules requiring dealers to report all transactions in US corporate bonds and preferred stocks to the NASD and to develop systems to receive and distribute transaction prices on an immediate basis.

Second, create a database of transactions in corporate bonds and preferred stocks to enable regulators to take a proactive role in supervising the corporate debt market.

Third, create a surveillance program, in conjunction with the development of a database, to better detect fraud and foster investor confidence in the fairness of the corporate debt market.

In response to this mandate, the NASD is proposing a phased-in approach to corporate bond trade reporting, starting first with high yield and convertible debt instruments followed by all other eligible U.S. corporate bonds. Initially, the maximum time period for timely reporting

after trade execution will be 1 hour which will subsequently be compressed to 15 minutes. All corporate bond trade reports received, with the exception of Rule 144A restricted issues, will then be immediately disseminated to the investing public through market data vendors. The NASD expects to initiate mandatory corporate bond trade reporting and comparison for all NASD members in two phases. Currently, the target start date for mandatory reporting is the spring of 2000, with TRACE comparison service commencing in the summer of that same year, after the securities industry has successfully met the Y2K challenge.¹ The NASD's corporate bond trade reporting and dissemination initiative is to be accomplished in the following phases:

II. Corporate Bond Trade Reporting Implementation - Phase I

Under the NASD's proposal, mandatory trade reporting for high yield² and convertible corporate bonds will commence in the spring of the year 2000, after the NASD has assessed industry readiness. For the first month of reporting, these securities will be subject to a maximum 1 hour trade reporting window. At the end of the first month, an alphabetical phase-in of remaining reportable corporate bonds, lasting two months, will then begin.³ These corporate bonds will also be subject to a 1 hour maximum trade reporting window. While eligible corporate bonds are being incorporated into the mandatory trade reporting system, NASD will once again undertake

¹ Fees for this initiative will be the subject of a separate rule filing at a later date.

² Included in this category are the approximately 2900 high yield corporate bonds already being reported through Nasdaq's Fixed Income Pricing System ("FIPS"). As explained in Section IX. of this filing, the NASD intends to fold all FIPS securities into the larger corporate bond trade reporting and dissemination facility proposed here.

³ While NASD is initially proposing an alphabetical phase-in, the Association will continue to consult with bond market participants with a view towards determining whether a different method of phasing-in eligible bonds (e.g. by CUSIP number) is more appropriate. Regardless of the phase in method selected, the three month time period for completing the initial phase-in of all TRACE bonds will remain the same.

a review of industry technological and operational readiness and compliance with the new corporate bond trade reporting rules. With the exception of reports in FIPS 50 bonds, (See Section IX. below), during Phase I no trade reports will be disseminated.

III. Corporate Bond Trade Reporting Implementation - Phase II

At the end of the sixth months, the 1 hour maximum trade reporting window will be shortened to 15 minutes, and immediate dissemination of trade reports will begin (with the exception of Rule 144A restricted issues). During Phase II, the NASD will continue to evaluate the industry's compliance with the new rules, and examine whether a further reduction in the post-trade reporting window should be considered. The NASD will also assess the impact upon liquidity and seek industry input regarding any potential or observed negative impacts on market liquidity attributable to the reduced post-trade time reporting window and/or immediate dissemination of bond trade data.

IV. The Trade Reporting And Comparison Entry Service

Trade reports submitted by NASD firms will be entered into Nasdaq's TRACESM Service. TRACE, which is based in part on technology derived from Nasdaq's Automated Confirmation Transaction Service ("ACT"), is a multi-functional service designed to facilitate the reporting and comparison of fixed-income trades. The system allows reporting firms to enter executed trades in corporate bonds and have these trades available for trade reporting, matching, and clearing. Contra parties to reported corporate bond trades may accept trade entries made by the reporting party via an acceptance function, or by entering its version of the trade and allowing TRACE to match it. Trades submitted through TRACE are forwarded to Nasdaq for reporting

purposes and can also be forwarded to the National Securities Clearing Corporation ("NSCC") for clearance and settlement as "locked-in" trades. NASD believes that TRACE will provide significant benefits to corporate bond market participants by enabling faster and more efficient trade reconciliation and confirmation, increased efficiency in back-office operations, and a real-time trade entry status check for every TRACE transaction. These features will also facilitate the industry's transition toward T+1 trade settlement.

TRACE is also programmed to provide important risk management functions to firms that clear corporate bond transactions for other firms. For example, TRACE will allow clearing firms to monitor buy/sell trading activity of their introducing firms, establish trading thresholds, allow/inhibit large trades, add/delete clearing relationships and access a real-time data base of correspondent trading activity. Like TRACE's trade reporting and comparison features, TRACE's risk management capabilities are designed to increase corporate bond market participant confidence through the provision of superior, real-time market information.

V. Corporate Bonds Subject to Mandatory Trade Reporting

The NASD is proposing that trade reporting be mandated for the following corporate debt securities: 1) U.S. dollar denominated debt securities issued by U.S. and private foreign corporations that are registered with the SEC and eligible for book-entry services at the Depository Trust Company ("DTC"); 2) Rule 144A U.S. high-yield debt securities designated as "PORTAL Debt Securities" in Nasdaq's PORTAL Market⁴; 3) Rule 144A investment grade debt securities eligible for book-entry services at DTC. For clarification, the securities described

⁴ See SR-NASD-99-66.

above would include: a) investment grade corporate debt (including Rule 144A/DTC eligible); b) high-yield and unrated debt issued by U.S. companies and foreign private companies (including PORTAL-designated debt); c) medium-term notes; d) convertible bonds; and e) capital trust securities, floating rate notes, and global bonds issued by U.S. companies and foreign private companies. Reportable bonds would not include: sovereign or development bank debt; mortgage or asset backed securities; collateralized mortgage obligations ("CMOs"); or money market instruments.

VI. Reporting Obligations

Under the rules proposed here, trade reports in eligible corporate bond transactions between NASD members will be submitted by the NASD member on the sell side of the transaction. If the transaction involves an NASD member and the other party is a customer or non-member broker/dealer, the NASD member will be obligated to report regardless of whether the NASD member represents the buy or sell side of the transaction. NASD is proposing that the following types of trades be exempted from its mandatory corporate bond trade reporting rules: (1) transactions that are part of a primary distribution by the issuer; (2) transactions made in reliance on Section 4(2) of the Securities Act of 1933⁵; (3) transactions in listed debt securities that are both executed on, and reported to, a national securities exchange; or (4) transactions in which the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the debt security (e.g., to enable the seller to make a gift).

VII. Elements of the Trade Report

⁵ See SR-NASD-99-66 for fuller discussion regarding the application of exemptions (1) and (2) as they relate to Portal securities and Rule 144A investment grade debt.

The NASD is recommending that corporate bond trade reports submitted should include the following: 1.) Buy/Sell/Cross; 2.) CUSIP number or NASD symbol; 3.) Quantity; 4.) Price - inclusive of mark-up, mark-down, and stated commission (for agency trades stated commission will be reported in separate field)⁶; 5.) Contra-party's NASD symbol or "C" for customer; 6.) Date and Time of Trade Execution 7.) Capacity - Principal (with riskless principal reported as principal), Agent or Agency Cross. In-house crosses should be reported as follows: Agency crosses will be reported one time as an agency cross, and principal crosses will be reported twice as individual buy and sell principal trades. Baby Bonds (a trade quantity of less than one bond/\$1,000 face amount) trade reports will be based on the actual percentage of the bond traded and reported in decimal form (e.g. a face value of \$414 would be reported as .414). Given the potential for these trades to distort both market aggregates as well as the representative market in an individual bond, these trade reports will not be disseminated. Mixed lot trades, consisting of a denomination of \$1000 par or multiples thereof, plus a baby bond, will be reported as the actual number of bonds traded (e.g. 25,414) but will be disseminated as the lesser whole amount (e.g. 25M) after being rounded down by TRACE. Trade reports in "When-Issued" bonds would be reported on a yield basis, unless contracted on the dollar, and be specially designated when disseminated and not included in the calculation of daily market aggregate values.

VIII. Determining Time of Execution for Trade Reporting Purposes

⁶ In order to achieve both trade reporting and comparison of TRACE transactions, agency trades executed with a stated commission should have that commission reported in a separate data entry field provided for this purpose. The dollar price of the transaction should be reported without including the commission. TRACE will combine these two fields for dissemination of price and yield to the public, and use the price field for comparison purposes.

NASD is proposing that the time of execution entry on corporate bond trade reports be established as the time when all of the terms of the trade are agreed upon sufficient to calculate the dollar price of the trade. NASD believes that this standard is appropriate and consistent with the reference to time of execution in SEC Rule 17a-3(a)(6) and (7), which governs memorandums of purchase or sale for bond transactions.⁷

IX. Fixed Income Pricing System

The rules of Nasdaq's Fixed Income Pricing System ("FIPS") already mandate that certain high yield bonds, known as the "FIPS 50", be reported to the FIPS system within 5 minutes of trade execution, with the remainder of FIPS-reportable corporate high yield bonds being subject to a 5:00 p.m. end-of-day reporting deadline. In addition, Nasdaq also currently imposes a one-sided quotation obligation on NASD members for each FIPS bond in which they act as a dealer. In order to standardize corporate bond trade reporting obligations and minimize industry technology burdens, NASD is proposing to eliminate the separate FIPS system, and its related rules and costs, in conjunction with the expansion of corporate bond trade reporting proposed in this filing. This will be accomplished as follows: First, FIPS quotation requirements will cease upon commencement of high-yield corporate bond trade reporting mandated in this filing. At the same

time, the current 5 minute trade reporting window for FIPS 50 bonds will be expanded to 1 hour and Nasdaq's current hourly dissemination of the high, low, and volume of the FIPS 50 bonds will be shortened to immediate dissemination of actual FIPS 50 trade reports when received by Nasdaq. At the inception of mandatory high-yield corporate bond trade reporting proposed in

⁷ For determining the time of execution for transactions involving PORTAL debt and Rule 144A investment grade

this filing, all former FIPS securities, including those now reported at the end of the day, will become governed by the same 1 hour/15 minute reporting and immediate dissemination standards applicable to all TRACE-eligible corporate bonds. In addition to establishing uniformity and an equality of trade reporting burdens, NASD believes that immediate, upon-receipt dissemination of FIPS 50 trade reports will provide the fastest opportunity to begin evaluation of the market impact of corporate bond trade reporting and dissemination.

X. Methods of Trade Reporting

NASD is actively conferring with various market participants including market data vendors to provide a myriad of options for market participants to report corporate bond trades. It is the NASD's goal to make available trade reporting options appropriate for every type of NASD member firm. Specifically, the TRACE system will be developed in a manner that will make it possible for vendors and service bureaus to provide trade report data on behalf of their clients, via a Nasdaq Computer to Computer Interface ("CTCI"). In addition, a browser-based corporate bond software application is being developed which will allow members to manually enter trade report information via the Internet or other private network. Currently, the target start date for mandatory reporting is the spring of 2000, with TRACE comparison service commencing in the summer of that same year.

XI. Hours of System Operation

NASD's corporate bond trade reporting and dissemination system will operate from 8:00 a.m. to 6:30 p.m. Eastern Time. Trades executed after 6:30 p.m. and before 8 a.m. the next day, will be

reported that next morning beginning at 8 a.m. in conformity with maximum trade reporting time mandates (e.g. initially 1 hour subsequently to be reduced to 15 minutes). Trades executed after system close and before 12:00 a.m. midnight will be reported on an “as of” basis and will not be included in market aggregates but will be disseminated upon receipt beginning at 8:00 a.m. the next trading day. Trades executed between 12:01 a.m. and system open (8:00 a.m.) that same day will be reported starting at system open, disseminated upon receipt, and will be included in the calculation of daily aggregates.

XII. Corporate Bond Market Surveillance

In addition to the establishment of a corporate bond transaction reporting and dissemination facility, NASD will also, in accordance with the Commission mandate, develop a database of transactions in corporate bonds to enable NASD Regulation and Nasdaq MarketWatch regulators to take a proactive role in supervising the corporate debt market and to better detect fraud and foster investor confidence in the fairness of that market. As the Commission is aware, both NASD Regulation and Nasdaq currently have in place surveillance and examination programs covering the over-the-counter corporate debt market, NASD Regulation will continue to investigate complaints concerning over-the-counter corporate bond transactions and will, based on the database of TRACE transactions reports submitted, develop automated monitoring and oversight capabilities for the corporate debt market to ensure the highest levels of investor protection and market integrity.

XIII. Dissemination of Trade Report Information to Vendors

NASD is proposing to immediately disseminate the following trade report information to market data vendors for public use: 1.) NASD Symbol; 2.) CUSIP; 3.) Date/Time of Execution of Trade; 4.) Price; 5.) Yield, and 6.) Actual Quantity of Bonds Traded (except high yield and unrated (NR/NA) trades over a 1 million dollar par value will be disseminated as "1MM+" and investment-grade transactions over a 5 million dollar par value will be disseminated as "5MM+").⁸ NASD believes a two-tiered approach of a 1MM+ identifier for high-yield transactions is appropriate given the lack of effective hedges in the high-yield market and that market's potential sensitivity to a lack of liquidity, while a 5MM+ identifier for investment-grade trades draws an appropriate and reasonable balance between the desire for increased transparency

and any potential dangers to market function in the more liquid investment-grade debt market.⁹ TRACE information will be distributed to vendors in a fashion and format similar to Nasdaq's Trade Dissemination Service ("NTDS") which is used to disseminate last sale transaction reports in Nasdaq securities.

Based on the above, Nasdaq believes that the proposed rule changes are consistent with the provisions of Section 15A(b)(6) of the Act in that the proposals are designed to prevent manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in the regulating, clearing, settling, processing information with respect to, and facilitating transactions in, securities.

⁸ NASD will not disseminate trade report information for transactions involving Rule 144A-eligible, privately-placed debt securities, including PORTAL-designated and investment grade DTC-eligible debt. Trade reports in stand-alone baby bonds will also not be disseminated (See Section VII).

⁹ TRACE will disseminate transaction reports received during system hours. However, only TRACE transactions executed and reported to TRACE prior to 5:15 p.m. Eastern Time will be used to calculate that day's high, low, last sale, and volume for individual TRACE securities. Transaction reports submitted to TRACE after 5:15 p.m. Eastern Time will be disseminated with a ".A" to identify them as transactions not affecting high, low, last sale, and volume market aggregates.

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

Nasdaq 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.

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

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

NASD consents to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act sufficient to allow a 60-day public comment period on this proposal.

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

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

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD has caused this filing to be signed on its behalf by the duly authorized undersigned.

THE NATIONAL ASSOCIATION OF
SECURITIES DEALERS, INC.

BY: _____
Joan C. Conley
Corporate Secretary

Date: October 27, 1999

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-99-65)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to the Creation of a Corporate Bond Trade Reporting and Transaction Dissemination Facility and the Elimination of Nasdaq's Fixed Income Pricing System ("FIPS")

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on the National Association of Securities Dealers, Inc. ("NASD" or "Association") 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 the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD is proposing to amend, delete and create numerous rules of the Association to establish a corporate bond trade reporting and transaction dissemination facility. Attached as Appendix I is the text of these proposed rule changes. Proposed new language is in italics; proposed deletions are in brackets.

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

The NASD is proposing to establish a mandatory trade reporting, dissemination and comparison facility for corporate bonds. Under the proposal, beginning in the spring of the year 2000, NASD members would be obligated, for regulatory purposes, to trade report to Nasdaq's Trade Reporting And Comparison Entry Service ("TRACESM") all secondary transactions in specified U.S. corporate bonds within 1 hour of trade execution. After an initial 6 month period for an information integrity review, Nasdaq will in turn disseminate trade reports to the public through market data vendors. Under the proposal, the initial 1 hour maximum trade reporting time frame will be subsequently reduced to 15 minutes six months after corporate bond trade reporting begins. Simultaneously with the effectiveness of the new rules governing corporate bond trade reporting, the NASD will also eliminate Nasdaq's FIPS system and its related rules.

I. Background

Early in 1998, the Securities and Exchange Commission ("SEC") began reviewing the debt markets in the United States with a particular emphasis on price transparency. This review concluded that in the area of corporate bonds, transparency was lacking and needed improvement. Subsequently, the Chairman of the SEC again highlighted the problem of the lack of transparency in the corporate bond market and called on the NASD to take the following actions:

First, adopt rules requiring dealers to report all transactions in US corporate bonds and preferred stocks to the NASD and to develop systems to receive and distribute transaction prices on an immediate basis.

Second, create a database of transactions in corporate bonds and preferred stocks to enable regulators to take a proactive role in supervising the corporate debt market.

Third, create a surveillance program, in conjunction with the development of a database, to better detect fraud and foster investor confidence in the fairness of the corporate debt market.

In response to this mandate, the NASD is proposing a phased-in approach to corporate bond trade reporting, starting first with high yield and convertible debt instruments followed by all other eligible U.S. corporate bonds. Initially, the maximum time period for timely reporting after trade execution will be 1 hour which will subsequently be compressed to 15 minutes. All corporate bond trade reports received, with the exception of Rule 144A restricted issues, will then be immediately disseminated to the investing public through market data vendors. The NASD expects to initiate mandatory corporate bond trade reporting and comparison for all NASD members in two phases. Currently, the target start date for mandatory reporting is the spring of 2000, with TRACE comparison service commencing in the summer of that same year, after the securities industry has successfully met the Y2K challenge.¹⁰ The NASD's corporate bond trade reporting and dissemination initiative is to be accomplished in the following phases:

II. Corporate Bond Trade Reporting Implementation - Phase I

Under the NASD's proposal, mandatory trade reporting for high yield¹¹ and convertible corporate bonds will commence in the spring of the year 2000, after the NASD has assessed

¹⁰ Fees for this initiative will be the subject of a separate rule filing at a later date.

¹¹ Included in this category are the approximately 2900 high yield corporate bonds already being reported through Nasdaq's Fixed Income Pricing System ("FIPS"). As explained in Section IX. of this filing, the NASD intends to fold all FIPS securities into the larger corporate bond trade reporting and dissemination facility proposed here.

industry readiness. For the first month of reporting, these securities will be subject to a maximum 1 hour trade reporting window. At the end of the first month, an alphabetical phase-in of remaining reportable corporate bonds, lasting two months, will then begin.¹² These corporate bonds will also be subject to a 1 hour maximum trade reporting window. While eligible corporate bonds are being incorporated into the mandatory trade reporting system, NASD will once again undertake a review of industry technological and operational readiness and compliance with the new corporate bond trade reporting rules. With the exception of reports in FIPS 50 bonds, (See Section IX. below), during Phase I no trade reports will be disseminated.

III. Corporate Bond Trade Reporting Implementation - Phase II

At the end of the sixth months, the 1 hour maximum trade reporting window will be shortened to 15 minutes, and immediate dissemination of trade reports will begin (with the exception of Rule 144A restricted issues). During Phase II, the NASD will continue to evaluate the industry's compliance with the new rules, and examine whether a further reduction in the post-trade reporting window should be considered. The NASD will also assess the impact upon liquidity and seek industry input regarding any potential or observed negative impacts on market liquidity attributable to the reduced post-trade time reporting window and/or immediate dissemination of bond trade data.

IV. The Trade Reporting And Comparison Entry Service

¹² While NASD is initially proposing an alphabetical phase-in, the Association will continue to consult with bond market participants with a view towards determining whether a different method of phasing-in eligible bonds (e.g. by CUSIP number) is more appropriate. Regardless of the phase in method selected, the three month time period for completing the initial phase-in of all TRACE bonds will remain the same.

Trade reports submitted by NASD firms will be entered into Nasdaq's TRACESM Service. TRACE, which is based in part on technology derived from Nasdaq's Automated Confirmation Transaction Service ("ACT"), is a multi-functional service designed to facilitate the reporting and comparison of fixed-income trades. The system allows reporting firms to enter executed trades in corporate bonds and have these trades available for trade reporting, matching, and clearing. Contra parties to reported corporate bond trades may accept trade entries made by the reporting party via an acceptance function, or by entering its version of the trade and allowing TRACE to match it. Trades submitted through TRACE are forwarded to Nasdaq for reporting purposes and can also be forwarded to the National Securities Clearing Corporation ("NSCC") for clearance and settlement as "locked-in" trades. NASD believes that TRACE will provide significant benefits to corporate bond market participants by enabling faster and more efficient trade reconciliation and confirmation, increased efficiency in back-office operations, and a real-time trade entry status check for every TRACE transaction. These features will also facilitate the industry's transition toward T+1 trade settlement.

TRACE is also programmed to provide important risk management functions to firms that clear corporate bond transactions for other firms. For example, TRACE will allow clearing firms to monitor buy/sell trading activity of their introducing firms, establish trading thresholds, allow/inhibit large trades, add/delete clearing relationships and access a real-time data base of correspondent trading activity. Like TRACE's trade reporting and comparison features, TRACE's risk management capabilities are designed to increase corporate bond market participant confidence through the provision of superior, real-time market information.

V. Corporate Bonds Subject to Mandatory Trade Reporting

The NASD is proposing that trade reporting be mandated for the following corporate debt securities: 1) U.S. dollar denominated debt securities issued by U.S. and private foreign corporations that are registered with the SEC and eligible for book-entry services at the Depository Trust Company (“DTC”); 2) Rule 144A U.S. high-yield debt securities designated as "PORTAL Debt Securities" in Nasdaq's PORTAL Market¹³; 3) Rule 144A investment grade debt securities eligible for book-entry services at DTC. For clarification, the securities described above would include: a) investment grade corporate debt (including Rule 144A/DTC eligible); b) high-yield and unrated debt issued by U.S. companies and foreign private companies (including PORTAL-designated debt); c) medium-term notes; d) convertible bonds; and e) capital trust securities, floating rate notes, and global bonds issued by U.S. companies and foreign private companies. Reportable bonds would not include: sovereign or development bank debt; mortgage or asset backed securities; collateralized mortgage obligations ("CMOs"); or money market instruments.

VI. Reporting Obligations

Under the rules proposed here, trade reports in eligible corporate bond transactions between NASD members will be submitted by the NASD member on the sell side of the transaction. If the transaction involves an NASD member and the other party is a customer or non-member broker/dealer, the NASD member will be obligated to report regardless of whether the NASD member represents the buy or sell side of the transaction. NASD is proposing that the following types of trades be exempted from its mandatory corporate bond trade reporting rules: (1) transactions that are part of a primary distribution by the issuer; (2) transactions made in reliance

¹³ See SR-NASD-99-66.

on Section 4(2) of the Securities Act of 1933¹⁴; (3) transactions in listed debt securities that are both executed on, and reported to, a national securities exchange; or (4) transactions in which the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the debt security (e.g., to enable the seller to make a gift).

VII. Elements of the Trade Report

The NASD is recommending that corporate bond trade reports submitted should include the following: 1.) Buy/Sell/Cross; 2.) CUSIP number or NASD symbol; 3.) Quantity; 4.) Price - inclusive of mark-up, mark-down, and stated commission (for agency trades stated commission will be reported in separate field)¹⁵; 5.) Contra-party's NASD symbol or "C" for customer; 6.) Date and Time of Trade Execution 7.) Capacity - Principal (with riskless principal reported as principal), Agent or Agency Cross. In-house crosses should be reported as follows: Agency crosses will be reported one time as an agency cross, and principal crosses will be reported twice as individual buy and sell principal trades. Baby Bonds (a trade quantity of less than one bond/\$1,000 face amount) trade reports will be based on the actual percentage of the bond traded and reported in decimal form (e.g. a face value of \$414 would be reported as .414). Given the potential for these trades to distort both market aggregates as well as the representative market in an individual bond, these trade reports will not be disseminated. Mixed lot trades, consisting of a denomination of \$1000 par or multiples thereof, plus a baby bond, will be reported as the actual number of bonds traded (e.g. 25,414) but will be disseminated as the lesser whole amount (e.g.

¹⁴ See SR-NASD-99-66 for fuller discussion regarding the application of exemptions (1) and (2) as they relate to Portal securities and Rule 144A investment grade debt.

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25M) after being rounded down by TRACE. Trade reports in "When-Issued" bonds would be reported on a yield basis, unless contracted on the dollar, and be specially designated when disseminated and not included in the calculation of daily market aggregate values.

VIII. Determining Time of Execution for Trade Reporting Purposes

NASD is proposing that the time of execution entry on corporate bond trade reports be established as the time when all of the terms of the trade are agreed upon sufficient to calculate the dollar price of the trade. NASD believes that this standard is appropriate and consistent with the reference to time of execution in SEC Rule 17a-3(a)(6) and (7), which governs memorandums of purchase or sale for bond transactions.¹⁶

IX. Fixed Income Pricing System

The rules of Nasdaq's Fixed Income Pricing System ("FIPS") already mandate that certain high yield bonds, known as the "FIPS 50", be reported to the FIPS system within 5 minutes of trade execution, with the remainder of FIPS-reportable corporate high yield bonds being subject to a 5:00 p.m. end-of-day reporting deadline. In addition, Nasdaq also currently imposes a one-sided quotation obligation on NASD members for each FIPS bond in which they act as a dealer. In order to standardize corporate bond trade reporting obligations and minimize industry technology burdens, NASD is proposing to eliminate the separate FIPS system, and its related rules and costs, in conjunction with the expansion of corporate bond trade reporting proposed in

dollar price of the transaction should be reported without including the commission. TRACE will combine these two fields for dissemination of price and yield to the public, and use the price field for comparison purposes.

¹⁶ For determining the time of execution for transactions involving PORTAL debt and Rule 144A investment grade rated debt securities see SR-NASD-99-66.

this filing. This will be accomplished as follows: First, FIPS quotation requirements will cease upon commencement of high-yield corporate bond trade reporting mandated in this filing. At the same

time, the current 5 minute trade reporting window for FIPS 50 bonds will be expanded to 1 hour and Nasdaq's current hourly dissemination of the high, low, and volume of the FIPS 50 bonds will be shortened to immediate dissemination of actual FIPS 50 trade reports when received by Nasdaq. At the inception of mandatory high-yield corporate bond trade reporting proposed in this filing, all former FIPS securities, including those now reported at the end of the day, will become governed by the same 1 hour/15 minute reporting and immediate dissemination standards applicable to all TRACE-eligible corporate bonds. In addition to establishing uniformity and an equality of trade reporting burdens, NASD believes that immediate, upon-receipt dissemination of FIPS 50 trade reports will provide the fastest opportunity to begin evaluation of the market impact of corporate bond trade reporting and dissemination.

X. Methods of Trade Reporting

NASD is actively conferring with various market participants including market data vendors to provide a myriad of options for market participants to report corporate bond trades. It is the NASD's goal to make available trade reporting options appropriate for every type of NASD member firm. Specifically, the TRACE system will be developed in a manner that will make it possible for vendors and service bureaus to provide trade report data on behalf of their clients, via a Nasdaq Computer to Computer Interface ("CTCI"). In addition, a browser-based corporate bond software application is being developed which will allow members to manually enter trade

report information via the Internet or other private network. Currently, the target start date for mandatory reporting is the spring of 2000, with TRACE comparison service commencing in the summer of that same year.

XI. Hours of System Operation

NASD's corporate bond trade reporting and dissemination system will operate from 8:00 a.m. to 6:30 p.m. Eastern Time. Trades executed after 6:30 p.m. and before 8 a.m. the next day, will be reported that next morning beginning at 8 a.m. in conformity with maximum trade reporting time mandates (e.g. initially 1 hour subsequently to be reduced to 15 minutes). Trades executed after system close and before 12:00 a.m. midnight will be reported on an "as of" basis and will not be included in market aggregates but will be disseminated upon receipt beginning at 8:00 a.m. the next trading day. Trades executed between 12:01 a.m. and system open (8:00 a.m.) that same day will be reported starting at system open, disseminated upon receipt, and will be included in the calculation of daily aggregates.

XII. Corporate Bond Market Surveillance

In addition to the establishment of a corporate bond transaction reporting and dissemination facility, NASD will also, in accordance with the Commission mandate, develop a database of transactions in corporate bonds to enable NASD Regulation and Nasdaq MarketWatch regulators to take a proactive role in supervising the corporate debt market and to better detect fraud and foster investor confidence in the fairness of that market. As the Commission is aware, both NASD Regulation and Nasdaq currently have in place surveillance and examination programs covering the over-the-counter corporate debt market, NASD Regulation will continue to investigate complaints concerning over-the-counter corporate bond transactions and will, based

on the database of TRACE transactions reports submitted, develop automated monitoring and oversight capabilities for the corporate debt market to ensure the highest levels of investor protection and market integrity.

XIII. Dissemination of Trade Report Information to Vendors

NASD is proposing to immediately disseminate the following trade report information to market data vendors for public use: 1.) NASD Symbol; 2.) CUSIP; 3.) Date/Time of Execution of Trade; 4.) Price; 5.) Yield, and 6.) Actual Quantity of Bonds Traded (except high yield and unrated (NR/NA) trades over a 1 million dollar par value will be disseminated as “1MM+” and investment-grade transactions over a 5 million dollar par value will be disseminated as “5MM+”).¹⁷ NASD believes a two-tiered approach of a 1MM+ identifier for high-yield transactions is appropriate given the lack of effective hedges in the high-yield market and that market's potential sensitivity to a lack of liquidity, while a 5MM+ identifier for investment-grade trades draws an appropriate and reasonable balance between the desire for increased transparency

and any potential dangers to market function in the more liquid investment-grade debt market.¹⁸

TRACE information will be distributed to vendors in a fashion and format similar to Nasdaq's Trade Dissemination Service ("NTDS") which is used to disseminate last sale transaction reports in Nasdaq securities.

¹⁷ NASD will not disseminate trade report information for transactions involving Rule 144A-eligible, privately-placed debt securities, including PORTAL-designated and investment grade DTC-eligible debt. Trade reports in stand-alone baby bonds will also not be disseminated (See Section VII).

¹⁸ TRACE will disseminate transaction reports received during system hours. However, only TRACE transactions executed and reported to TRACE prior to 5:15 p.m. Eastern Time will be used to calculate that day's high, low, last sale, and volume for individual TRACE securities. Transaction reports submitted to TRACE after 5:15 p.m. Eastern Time will be disseminated with a ".A" to identify them as transactions not affecting high, low, last sale, and volume market aggregates.

Based on the above, Nasdaq believes that the proposed rule changes are consistent with the provisions of Section 15A(b)(6) of the Act in that the proposals are designed to prevent manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in the regulating, clearing, settling, processing information with respect to, and facilitating transactions in, securities.

(B) Self-Regulatory Organization's Statement on Burden on Competition

Nasdaq 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.

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

Written comments were neither solicited nor received.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 60 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C.

20549. 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. Copies of

such filing will also be available for inspection and copying at the principal office of the NASD.

All submissions should refer to the file number in the caption above and should be submitted by

[insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary

Appendix I

[6200. FIXED INCOME PRICING SYSTEM (FIPS)

Rules 6210. Through 6260 - Deleted]

6200. TRADE REPORTING AND COMPARISON ENTRY SERVICE (TRACE)

6210. Definitions

The terms used in this paragraph shall have the same meaning as those defined in the Association's By-Laws and Rules unless otherwise specified.

(a) The term "TRACE Eligible Security" shall mean all United States dollar denominated debt securities that are registered with the Securities and Exchange Commission and issued by United States and/or foreign private corporations and that are depository eligible securities as defined in Rule 11310(d); all debt securities qualified as PORTAL securities pursuant to Rule 5000 Series; all investment-grade rated debt securities that are issued pursuant to Section 4(2) of the Securities Act of 1933 and that are depository eligible securities pursuant to Rule 11310 (d).

(b) The term "Trade Reporting And Comparison Entry Service" or "TRACE" shall mean the automated system owned and operated by The Nasdaq Stock Market, Inc. that, among other things, accommodates reporting, comparison, and dissemination of transaction reports where applicable in TRACE Securities and which may submit "locked-in" trades to National Securities Clearing

Corporation for clearance and settlement and provide participants with monitoring and risk management capabilities to facilitate a "locked-in" trading environment.

(c) The term "reportable TRACE transaction" shall mean all transactions in a TRACE Eligible Security as required by this rule.

(d) The term "time of execution" for a transaction in a TRACE-eligible security shall be the time when all of the terms of the transaction are agreed to which are sufficient to calculate the dollar price of the trade. The time of execution for transactions involving TRACE-eligible securities that are trading "when issued" on a yield basis shall be when the yield for the transaction has been agreed to by the parties.

(e) The term "Parties to the Transaction" shall mean the executing broker/dealer, introducing broker/dealer, and clearing brokers, if any.

(f) The term "TRACE Participant" shall mean any NASD member in good standing that uses the TRACE system.

(g) The term “TRACE Reporting Party” shall mean a member of the Association that is registered as a TRACE participant with the Association and obligated to report a TRACE transaction pursuant to TRACE system rules and who is member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member.

(h) The term "TRACE Non-Reporting Party" shall mean a member of the Association that is registered as a TRACE participant with the Association who is not obligated to report under TRACE system rules for a particular transaction to which it is a party and who is member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member. It shall also mean any customer who is not a member of the Association.

(i) The term “Clearing Broker/Dealer” or “Clearing Broker” shall mean the member firm that has been identified in the TRACE system as principal for clearing and settling a trade, whether for its own account or for a correspondent firm.

(j) The term Correspondent Executing Broker/Dealer” or “Correspondent Executing Broker” shall mean the member firm that has been identified in the TRACE system as having a correspondent relationship with a clearing firm

whereby it executes trades and the clearing function is the responsibility of the clearing firm.

(k) The term “Introducing Broker/Dealer” or “introducing broker” shall mean the member firm that has been identified in the TRACE system as a party to the transaction, but does not execute or clear trades.

(l) The term "Browse" shall mean the functions of TRACE that permit a Participant to review (or query) for trades in the system identifying the Participant as a party to the transaction, subject to the specific uses contained in the TRACE Users Guide.

(m) The term “Gross Dollar Thresholds” in the risk management application of TRACE shall mean the daily dollar amounts for purchases and sales that a clearing broker establishes in the TRACE system for each correspondent executing broker that may be raised or lowered on an inter-day or intra-day basis. If the value of a correspondent’s trades equals or exceeds the gross dollar thresholds, the system will alert the clearing broker.

(n) The term “Pre-alert” shall mean the alert notifying the correspondent executing broker and the clearing broker that the correspondent executing broker has equaled or exceeded 70% of the purchase or sale gross dollar limits

established by the clearing broker. The Association reserves the right to modify the percentage of the pre-alert as necessary and upon prior notification to the TRACE Participants.

(o) The term "Single Trade Limit" shall mean the dollar amount established by the Clearing Broker for a single trade that enables a TRACE clearing firm to review the trade before it is obligated to clear the trade. When a correspondent executing broker negotiates a trade that equals or exceeds the Single Trade Limit, its clearing broker shall have a period of thirty (30) minutes to review and agree or decline to act as principal for clearing that trade. If a Clearing Broker fails to set a single trade limit the TRACE system will automatically set a default single trade limit of \$0 for the Correspondent Broker. The Association reserves the right to modify the minimum/maximum dollar amount of the Single Trade Limit as well as the time frame for clearing broker review as necessary and upon prior notification to the TRACE Participants.

(p) For purposes of these rules, the term "Investment Grade" shall mean any TRACE-eligible security rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories.

(q) For purposes of these rules, the term "Non-Investment Grade" shall mean any TRACE-eligible security that is unrated, non-rated, split-rated (where one rating falls below investment grade), or does not meet the definition of investment grade in paragraph (p), above.

6220. Participation in TRACE

(a) Mandatory Participation for Clearing Agency Members

(1) Pursuant to Article VII, Section 1(a)(vi) and (vii) of the By-Laws, participation in TRACE is mandatory for all brokers/dealers that are members of a clearing agency registered with the Commission pursuant to Section 17A of the Act, and for all brokers that have a clearing arrangement with such a broker. Such participation shall include the reconciliation of all over the counter clearing agency eligible transactions involving TRACE securities.

(2) Participation in TRACE shall be conditioned upon the TRACE Participant's initial and continuing compliance with the following requirements:

(A) execution of, and continuing compliance with, a TRACE Participant Application Agreement and all applicable rules and operating procedures of the Association and the Commission;

(B) membership in, or maintenance of, an effective clearing arrangement with a member of a clearing agency registered pursuant to the Act;

(C) maintenance of the physical security of the equipment located on the premises of the TRACE Participant to prevent unauthorized entry of information into TRACE; and

(D) acceptance and settlement of each trade that TRACE identifies as having been effected by such TRACE Participant, or if settlement is to be made through a clearing member, guarantee the acceptance and settlement of each TRACE identified trade by the clearing member on the regularly scheduled settlement date.

(3) Participation in TRACE as a Clearing Broker shall be conditioned upon the Clearing Broker's initial and continuing compliance with the following requirements:

(A) execution of, and continuing compliance with, a TRACE Participant Application Agreement and all applicable rules and operating procedures of the Association and the Commission;

(B) membership in a clearing agency registered pursuant to the Act;

(C) maintenance of the physical security of the equipment located on the premises of the TRACE Clearing Broker to prevent the unauthorized entry of information into TRACE; and

(D) acceptance and settlement of each trade that TRACE identifies as having been effected by itself or any of its correspondents on the regularly scheduled settlement date.

(4) Each TRACE Participant shall be obligated to inform the Association of non-compliance with, or changes to, any of the participation requirements set forth above.

(b) Participant Obligations in TRACE

(1) Access to TRACE

Upon execution and receipt by the Association of the TRACE Participant application agreement, a TRACE Participant may commence input and validation of trade information in TRACE eligible securities. TRACE Participants may access the service via an NASD-approved facility during the hours of operation.

(2) Clearing Obligations

If at any time a TRACE Participant fails to maintain a clearing arrangement, it shall be removed from the TRACE system until such time as a clearing arrangement is re-established and notice of such arrangement is provided to the Association. If, however, the Association finds that the TRACE Participant's failure to maintain a clearing arrangement is voluntary, the withdrawal will be considered voluntary and unexcused.

(3) Clearing Broker Obligations

(A) Clearing brokers may cease to act as principal for a correspondent executing broker at any time provided that notification has been given to, received and acknowledged by the TRACE Operations Center and

affirmative action has been completed by the Center to remove the correspondent broker from TRACE. The clearing broker's obligation to accept and clear trades for its correspondents shall not cease prior to the completion of all of the steps detailed in this subparagraph (3).

(B) TRACE Clearing brokers shall establish for each correspondent executing broker daily Gross Dollar Thresholds and may raise or lower the thresholds on an inter-day or intra-day basis. TRACE clearing brokers will receive a system alert when a correspondent executing broker equals or exceeds its gross dollar thresholds and will also receive a system pre-alert when a correspondent executing broker equals or exceeds 70% of the daily thresholds.

(C) For trades effected by a correspondent executing broker that equal or exceed the correspondent's Single Trade Limit set by the clearing broker in TRACE, clearing brokers have 30 minutes from the time of trade report input to TRACE to review the trade and accept or decline to act as principal to the trade. If the clearing broker does not make an affirmative acceptance or declination of the trade report within 30 minutes, the trade report will be subject to normal TRACE processing and the clearing broker will be obligated to act as principal for the trade.

6230. Transaction Reporting

(a) When and How Transactions are Reported

(1) All NASD members shall, within 1 Hour after trade execution, transmit through

TRACE during system hours, or if TRACE is unavailable due to system or transmission failure, by telephone to the TRACE Operations Center, reports of transactions in TRACE Securities executed between 8:00 a.m. and 6:30 p.m. Eastern Time or shall utilize the Browse function in TRACE to accept or decline trades within 30 minutes after execution according to paragraph (b) of this rule. Transactions not reported within 1 hour after execution shall be designated as late unless inadequate time remains prior to system close to allow a timely report. In this situation, the report must be made the next day at system open as designated "as/of."

(2) Transaction Reporting Between 6:30 p.m. and 8:00 a.m. Eastern Time

(A) Reports of transactions in TRACE Securities executed after 6:30 p.m.

Eastern Time and before 12:00 a.m. Eastern Time shall be reported on the next day and be designated "as/of". Such trade reports will not be included in daily market aggregates and will disseminated beginning at 8:00 a.m. Eastern Time on the day of receipt.

(B) Reports of transactions in TRACE Securities executed after 12:00

a.m. Eastern Time and before 8:00 a.m. Eastern Time shall be reported that same day beginning at 8:00 a.m. Eastern Time, within the maximum time frame mandated. Such trade reports will be included in that day's market aggregates and disseminated upon receipt.

A pattern or practice of late reporting without exceptional circumstances may be considered inconsistent with high standards of commercial honor and just and equitable

principles of trade, in violation of Rule 2110.

(b) Which Party Reports Transaction

Both parties executing a transaction shall, subject to the input requirements below, either input trade reports into the TRACE system or utilize the Browse feature to accept or decline a trade within the applicable time frames as specified in paragraph (a)(1) of this Rule. Trade data input obligations are as follows:

(1) in transactions between two TRACE Participants, the member representing the sell side shall be required to submit a trade report to TRACE;

(2) in transactions between an NASD member and a non-member including a customer, the NASD member shall be required to submit a trade report to TRACE.

(c) Trade Information To Be Reported

Each TRACE trade report shall contain the following information:

- (1) CUSIP number or NASD symbol;**
- (2) Number of bonds as required by paragraph (d) below;**
- (3) Price of the transaction as required by paragraph (d) below;**
- (4) A symbol indicating whether the transaction is a buy, sell or cross;**
- (5) Date of Trade Execution(as/of trades only);**
- (6) Contra-party's identifier;**
- (7) Capacity - Principal or Agent (with riskless principal reported**

as principal) as required by paragraph (d) below;

(8) Time of trade execution

(9) Reporting side executing broker as “give-up” (if any);

(10) Contra side introducing broker in case of “give-up” trade;

(11) Stated commission

(12) Such trade modifiers as required by either: a) the TRACE System Rules; and/or b) the TRACE Users Guide.

(d) Procedures for Reporting Price, Capacity, Volume

(1) For agency and principal transactions, report the price including the mark-up, mark-down or commission (commission entered separately). Do not include accrued interest.

(2) For agency and principal transactions, report the actual number of bonds traded. Baby bonds (those with a face value of less than \$1,000) should be reported expressed as a decimal.

(3) In house cross transactions should be reported as follows: Agency cross - report once as an agency trade; Principal cross - report twice, once as an individual principal buy and once as an individual principal sell.

(e) Transactions Not Required To Be Reported

The following types of transactions shall not be reported:

(1) Transactions which are part of a primary distribution by an issuer;

(2) Transactions made in reliance on Section 4(2) of the Securities Act of

1933;

(3) Transactions in listed securities that are both executed on, and reported to, a national securities exchange;

(4) Transactions where the buyer and the seller have agreed to trade at a price substantially unrelated to the current market for the TRACE security (e.g. to allow the seller to make a gift).

6240. TRACE Processing

Locked-in trades may be determined in the TRACE system by matching the trade information submitted by the reporting parties through one of the following methods:

(a) Trade by Trade Match

Both parties to the trade submit transaction data and the TRACE system performs an on-line match;

(b) Trade Acceptance

The TRACE reporting party enters its version of the trade into the system and the TRACE non-reporting contra party reviews the trade report and accepts or declines the trade. An acceptance results in a locked-in trade; a declined trade report is purged from the TRACE system at the end of trade date processing;

(c) Post Trade Date Processing

T+N entries may be submitted during system hours each business day. At the end of daily matching, all declined trade entries will be purged from the TRACE system.

TRACE will not purge any open trade (i.e. unmatched or unaccepted) at the end of its entry day, but will carry-over such trades to the next business day for continued comparison and reconciliation. TRACE will automatically lock in and submit to NSCC as such any carried-over T to T+21 (calendar day) trade if it remains open as of 2:30 p.m. on the next business day. TRACE will not automatically lock in T+22 (calendar day) or older open "as-of" trades that were carried-over from the previous business day; these will be purged by TRACE at the end of the carry-over day if they remain open. Members may re-submit these T+22 or older "as-of" trades as a comparison-only entry into TRACE on the next business day for continued comparison and reconciliation for up to one calendar year.

6250. TRACE Risk Management Functions

The TRACE system will provide the following risk management capabilities to clearing brokers:

(a) Trade File Scan

Clearing brokers will be able to scan the trading activities of their correspondent executing brokers through the TRACE system.

(b) Gross Dollar Threshold

Clearing brokers will be able to establish, on an inter-day or intra-day basis, gross dollar thresholds for purchases and sales for their correspondent executing brokers,

and the TRACE system will alert the clearing broker and its correspondent if the correspondent's trading activity equals or exceeds either threshold.

(c) Gross Dollar Threshold Pre-Alert

In addition to the gross dollar threshold alert, the TRACE system will also alert the clearing broker and its correspondent when the correspondent's trading activity equals or exceeds 70% of either gross dollar threshold.

(d) On-line Review

Clearing brokers that access TRACE through a computer interface will be able to receive intra-day activity of their correspondents as it is reported.

(e) Single Trade Limit

Clearing brokers will have 30 minutes from trade report input to TRACE to review any single trade executed by their correspondent executing brokers that equals or exceeds an amount set by the clearing broker for that correspondent in order to decide to act as principal. If, however, the clearing broker does not affirmatively accept or decline the trade, at the end of 30 minutes, the system will subject the trade to normal TRACE processing and the clearing broker will be obligated to act as principal to clear the trade.

(f) Super Cap

The Super Cap will be set at an amount to be determined by the Clearing Broker, but in no event less than the gross dollar threshold. When a correspondent's Super

Cap is reached, notice will be furnished to TRACE participants, and no trade in excess of an amount set by the clearing broker for that correspondent will be accepted for TRACE processing unless the clearing broker accepts the trade within 30 minutes of execution.

6260. Obligation to Honor Trades

If a TRACE Participant is reported by TRACE as a party to a trade that has been treated as locked-in and sent to NSCC, notwithstanding any other agreement to the contrary, that party shall be obligated to act as a principal to the trade and shall honor such trade on the scheduled settlement date.

6261. Compliance with TRACE Rules and Trade Reporting Requirements

Failure of an NASD member, or person associated with a member, to comply with any of the rules or requirements of TRACE, or failure of a member or associated person to comply with any of the transaction reporting requirements for TRACE-Eligible Securities may be considered conduct inconsistent with high standards of commercial honor and just and equitable principals of trade, in violation of Rule 2110.

6270. Audit Trail Requirements

The data elements specified in Rule 6220(c) are critical to the Association's compilation of a transaction audit trail for regulatory purposes. As such, all member firms utilizing the

TRACE Service have an ongoing obligation to input 6220(c) information accurately and completely.

6280. Termination of TRACE Service

The Association may, upon notice, terminate TRACE service to a Participant in the event that an TRACE Participant fails to abide by any of the rules or operating procedures of the TRACE service or the Association, or fails to honor contractual agreements entered into with the Association or its subsidiaries, or fails to pay promptly for services rendered by the TRACE Service.

6290. Dissemination of Corporate Bond Trade Information

Trade reports entered into TRACE will be collected, processed and disseminated on a real-time basis between 8:00 a.m. and 6:30 p.m. Eastern Time. All trade reports submitted to TRACE prior to 5:15 will be included in the calculation of market aggregates and last sale except 1). trades reported on an “as of” basis, 2) “when issued” trades executed on a yield basis, or 3) trades in baby bonds with a par value of less than \$1000.

6291. Lead Underwriter Information Obligation

In order to facilitate trade reporting of secondary transactions in TRACE securities, the lead underwriter of any newly-issued TRACE security shall provide to the TRACE Operations Center the CUSIP number of any debt issue no later than on the effective date

of the offering.