

INFORMATIONAL

Fixed Income Transaction Reporting And Dissemination

SEC Approves Rules To Require Fixed Income Transaction Reporting And Dissemination; Effective Date: 180 Days After Publication Of TRACE Technical Specifications

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- Corporate Finance
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- Training

KEY TOPICS

- Fixed Income Securities
- Dissemination
- Operations
- Transaction Reporting
- Trading

Executive Summary

On January 23, 2001, the Securities and Exchange Commission (SEC) approved proposed rules that will require National Association of Securities Dealers, Inc. (NASD® or Association) members to report secondary market transactions in eligible fixed income securities to the NASD and subject certain transaction reports to dissemination.¹ The rules, referred to as the "TRACE rules," will be set forth in the new Rule 6200 Series and provide the following:

- 1) fixed income transactions that must be reported under the new TRACE rules are those secondary market transactions involving a "TRACE-eligible security";
- 2) the term "TRACE-eligible security" means all United States dollar denominated debt securities that are depository-eligible securities; Investment Grade and Non-Investment Grade (as defined in the TRACE rules); issued by United States and/or foreign private corporations; and: (1) registered with the SEC; or (2) issued pursuant to Section 4(2) of the Securities Act of 1933 (Securities Act) and purchased or sold pursuant to Rule 144A under the Securities Act;
- 3) the term "TRACE-eligible security" specifically excludes mortgage-or asset-backed securities, collateralized mortgage obligations, and money market instruments;
- 4) a member that is a party to a transaction involving a member and a non-member, including a customer, in a fixed income security that is a "TRACE-eligible security" must report the transaction to the NASD within one hour of the time of execution;

- 5) when the party on the sell side and the party on the buy side of a transaction in a "TRACE-eligible security" are both members, both members must report the transaction to the NASD within one hour of the time of execution;
- 6) the NASD will disseminate transaction information relating to transactions in the following two types of securities:
 - a) a TRACE-eligible security having an initial issuance size of \$1 billion or greater that is Investment Grade at the time of receipt of the transaction report (except those securities that are issued pursuant to Section 4(2) of the Securities Act and purchased or sold pursuant to Rule 144A); and
 - b) a TRACE-eligible security that is designated as a Fixed Income Pricing System (FIPS) security (a FIPS 50 security) immediately prior to the time that the FIPS rules² (the current Rule 6200 Series) are rescinded; and
- 7) dissemination in the securities transactions referenced in 6 above will occur immediately after the transaction information is received by the NASD.

The TRACE rules will become effective 180 days following the NASD's publication of the TRACE technical specifications for members. On or near that time, the NASD will announce the specific date of effectiveness of the TRACE rules in an *NASD Notice to Members*. When the TRACE rules take effect, the FIPS rules, which are set forth in the current Rule 6200 Series, will be rescinded. The TRACE rules are provided in Attachment A.

Questions/Further Information

Questions regarding this Notice may be directed to Justin Tubiolo, Vice President, Fixed Income Department, NASD, at 212-858-4419, or by e-mail at justin.tubiolo@nasd.com, or Sharon K. Zackula, Assistant General Counsel, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8985, or by e-mail at sharon.zackula@nasd.com.

Background

The SEC approved SR-NASD-99-65, the TRACE rules, after more than two years of industry and NASD discussion and review. The NASD received and considered many comments, and, in response to comments, made significant changes to the original proposal. With the implementation of the TRACE rules, secondary market transactions in broad categories of registered and unregistered debt instruments will become subject to reporting for the first time. In addition, price and other transaction information in two types of debt instruments will be publicly disseminated for the first time. In order for the industry to prepare for such changes, the NASD has delayed the effective date and implementation of the TRACE rules to allow for technological changes to be made throughout the industry. The scope of the regulatory changes and the schedule for implementation are described in greater detail below.

Discussion

The TRACE rules have three main components: (1) identifying those fixed income securities transactions that are required to be reported; (2) detailing the reporting requirements; and (3) identifying those fixed income securities

transactions that are subject to dissemination.

TRACE-Eligible Securities

If a fixed income security is a "TRACE-eligible security," generally transactions in such securities to which a member is a party must be reported to the NASD.³ Most corporate debt securities fall within the definition of "TRACE-eligible security." Specifically, "TRACE-eligible security" means all United States dollar denominated debt securities that are depository-eligible securities; Investment Grade and Non-Investment Grade (as defined in TRACE Rule 6210(h) and (i), respectively); issued by United States and/or foreign private corporations; and: (1) registered with the SEC; or (2) issued pursuant to Section 4(2) under the Securities Act and purchased or sold pursuant to Rule 144A.⁴ Specifically excluded from the term "TRACE-eligible security" are mortgage- or asset-backed securities, collateralized mortgage obligations, and money market instruments.⁵ The term "TRACE-eligible security" also does not include municipal securities; thus, the TRACE rules do not apply to municipal securities, which are currently subject to reporting under the rules of the Municipal Securities Rulemaking Board. The TRACE rules do apply to those Non-Investment Grade (as defined in the TRACE rules)⁶ securities that are currently designated as "FIPS securities" or "FIPS 50 securities."⁷ In addition, securities that are sold in private placements under Section 4(2) of the Securities Act, are eligible for resale under Rule 144A, and are DTC eligible, including certain PORTAL debt securities, are "TRACE-eligible securities."

Reporting Requirements

A transaction in a TRACE-eligible security must be reported to the NASD within one hour of the time of execution by an NASD member.⁸ When two members are the parties to the transaction, both the member representing the sell side and the member representing the buy side must report the transaction.⁹ When a member is a party to a transaction involving a member and a non-member, including a customer, the member must submit the transaction report.¹⁰ Each transaction report must include: (1) CUSIP number or NASD symbol; (2) number of bonds; (3) price or the elements necessary to calculate the price, which are contract amount and accrued interest; (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 identifier; (7) capacity - principal or agent; (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" (if any); (11) stated commission; (12) such trade modifiers as required by the TRACE rules or the TRACE *users guide*; and (13) yield as required by Rule 10b-10 of the Securities Exchange Act of 1934.¹¹

Reporting Mechanisms

Members will be able to choose from among several different mechanisms in order to meet their reporting obligations. First, members may report directly through a Computer-to-Computer-Interface (CTCI). Second, members may report through a Web-based application that the NASD will provide. Third, vendors and service bureaus may provide a reporting service for their clients. Finally, the NASD and the National Securities Clearing Corporation

(NSCC) have agreed that members may forward transaction reports to NSCC, which will forward them to the NASD.

Dissemination

The TRACE rules provide that the Association will disseminate transaction information relating to transactions in two types of securities: (1) a TRACE-eligible security having an initial issuance size of \$1 billion or greater that is Investment Grade at the time of receipt of the transaction report (except those securities that are issued pursuant to Section 4(2) of the Securities Act and purchased or sold pursuant to Rule 144A); and (2) a TRACE-eligible security that is designated a "FIPS 50 security" immediately prior to the rescission of the FIPS rules.¹²

Not all of the information that is reported will be disseminated. For each transaction, the NASD will disseminate, or supply to vendors to disseminate, the following information: (a) NASD symbol for the fixed income security; (b) CUSIP; (c) date and time of trade execution; (d) price; (e) yield; and (f) quantity of bonds, subject to the following limitations.¹³ For a TRACE-eligible security having an initial issuance size of \$1 billion or greater that is Investment Grade as referenced above, the actual quantity of the transaction (the total par value of the bonds purchased or sold) will be disseminated if the total par value of the reported transaction is \$5 million or less; if the reported amount is greater than \$5 million, a large volume trade dissemination cap identifier of "5MM+" will be disseminated instead of the actual quantity. For a TRACE-eligible security that is designated as a "FIPS 50 security" as referenced above, the actual quantity of the transaction will be disseminated if

the total par value of the reported transaction is \$1 million or less; if the reported amount is greater than \$1 million, a large volume trade dissemination cap identifier of "1MM+" will be disseminated instead of the actual quantity.

Immediately upon receipt of transaction reports between 8:00 a.m. and 6:30 p.m., Eastern Time, the Association will disseminate the transaction information.¹⁴ (Reports received earlier or later than the times set forth above are also subject to dissemination as set forth in greater detail in TRACE Rule 6250(c) and (d).)

The Association expects that more fixed income securities transactions will become subject to dissemination in the future. In order to expand the classes and types of fixed income securities that would become subject to dissemination, the Association will work with the Bond Transaction Reporting Committee (BTRC), a special committee of the NASD that will be formed to analyze the effect that the dissemination of price and other information in certain TRACE-eligible securities transactions has upon the liquidity of those markets. Based in part on those results, the Association will determine a schedule for the dissemination of additional TRACE-eligible bonds.

Announcement Of Technical Specifications

The NASD will publish the technical specifications that members will need in order to make the technical changes required for members to comply with the TRACE rules. Publication will be on the NASD Regulation Web Site at www.nasdr.com. In addition, the technical specifications may be made available through other media.

Effective Date

The Association is not yet able to announce a specific date of effectiveness for the TRACE rules. Instead, the TRACE rules will take effect 180 days after the NASD provides the TRACE technical specifications to its members. The specific date of effectiveness will be announced in an *NASD Notice to Members* when the date is determined. When such rules become effective, both the reporting and the dissemination provisions will be in effect.

FIPS Rules Rescission

When the TRACE rules take effect, the FIPS rules, which are currently set forth in the Rule 6200 Series, will be rescinded. There are 50 securities, called the "FIPS 50 securities" for which certain price information is available currently. When the FIPS rules are rescinded, as noted above, transaction information in those FIPS 50 securities will be subject to dissemination under the new TRACE rules. As a result, pricing information for the FIPS 50 securities will continue to be available following the implementation of TRACE. The pricing and other information will be transaction-specific data that is updated continuously and, therefore, will be better data than the information that is available currently.¹⁵

Endnotes

- 1 See Securities Exchange Act Release No. 43873 (January 23, 2001); 66 Fed. Reg. 8131 (January 29, 2001) (File No. SR-NASD-99-65). On March 6, 2001, the SEC approved amendments to the Rule 5300 Series regarding the PORTAL Market (the PORTAL rules) to require members to submit trade reports of secondary market transactions in PORTAL-designated equity securities through the Automated Confirmation Transaction Service (ACT)

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- and certain PORTAL-designated debt securities in accordance with the TRACE rules. See *NASD Notice to Members 01-19*.
- 2 The FIPS rules are set forth in the current Rule 6200 Series.
 - 3 See TRACE Rule 6230. Paragraph (e) of the rule sets forth limited exceptions to the general reporting requirement.
 - 4 TRACE Rule 6210(a).
 - 5 *Id.*
 - 6 TRACE Rule 6210(i).
 - 7 The FIPS 50 securities will be published in a future *NASD Notice to Members*. However, a member will not be subject to two types of reporting requirements because the member's obligations under the FIPS rules will cease when the TRACE rules become effective.
 - 8 TRACE Rule 6230(a). Although the current reporting period is one hour, the NASD expects to propose to the SEC that the reporting period be reduced to 15 minutes (or an even shorter period). The NASD expects this to occur as the NSCC moves toward using a real-time messaging approach, and away from its current "multi-batch" reporting, as part of the industry's T + 1 initiative.
 - 9 TRACE Rule 6230(b)(1). As originally adopted, TRACE Rule 6230(b)(1) required only the member representing the sell side of the transaction to submit the transaction report. However, the SEC recently approved the Association's request for an amendment to TRACE Rule 6230(b)(1) that requires both members to report a transaction, which is known as "dual trade reporting." See SR-NASD-01-04, approved in Securities Exchange Act Release No. 44039 (March 5, 2001).
 - 10 TRACE Rule 6230(b)(2).
 - 11 TRACE Rule 6230(c). The term "Introducing Broker" is defined in TRACE Rule 6210(g).
 - 12 TRACE Rule 6250(a).
 - 13 For each security, the highest price of the day, the lowest price of the day, and the last sale price of the day also will be "flagged" or "marked" with indicators for dissemination, when applicable. Certain modifiers also may be part of the information disseminated.
 - 14 TRACE Rule 6250(a).
 - 15 TRACE Rule 6250(a)(2). For a "FIPS 50 security," the NASD currently disseminates only the following information, which is updated only once an hour: (1) the highest and lowest price of the prior hour and the aggregate volume for the prior hour; and (2) the highest price and lowest price of the day and the aggregate daily volume. FIPS Rule 6250(b).

ATTACHMENT A

Text of Rule Changes.

Note: New language is underlined; deletions are in brackets.

[6200. FIXED INCOME PRICING SYSTEM (FIPS)]

Note: The current Rule 6200 Series relating to FIPS will be deleted in its entirety and replaced with the rule text set forth below.

6200. TRADE REPORTING AND COMPARISON ENTRY SERVICE (TRACE)

6210. Definitions

The terms used in this Rule 6200 Series 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 depository eligible securities under Rule 11310(d); Investment Grade or Non-Investment Grade; issued by United States and/or foreign private corporations; and: (1) registered with the Securities and Exchange Commission; or (2) issued pursuant to Section 4(2) of the Securities Act of 1933 and purchased or sold pursuant to Rule 144A. The term "TRACE-eligible security" excludes mortgage- or asset-backed securities, collateralized mortgage obligations, and money market instruments.

(b) The term "Trade Reporting And Comparison Entry Service" or "TRACE" shall mean the automated system owned and operated by the NASD that, among other things, accommodates reporting and dissemination of transaction reports where applicable in TRACE-eligible 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 any transaction in a TRACE-eligible security.

(d) The term "time of execution" for a transaction in a TRACE-eligible security shall be the time when the parties to the transaction agree to all of the terms of the transaction that 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 to the transaction.

(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 that uses the TRACE system.

(g) The term "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.

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(h) 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.

(i) 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 (h) above.

6220. Participation in TRACE

(a) Mandatory Member Participation

(1) Member participation in TRACE for trade reporting purposes is mandatory. Such mandatory participation obligates members to submit transaction reports in TRACE-eligible securities in conformity with the Rule 6200 Series.

(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; and

(B) Maintenance of the physical security of the equipment located on the premises of the TRACE Participant to prevent unauthorized entry of information into TRACE.

(3) 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. This section shall not apply to TRACE Participants whose trading activity obviates the need for maintaining a clearing relationship.

6230. Transaction Reporting**(a) When and How Transactions are Reported**

(1) (A) Members that are required to report transaction information pursuant to paragraph (b) below shall, within one hour of the time of 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-eligible securities executed between 8:00 a.m. and 6:30 p.m. Eastern Time. Transactions not reported within one hour after the time of execution shall be designated as late; provided, however, that if inadequate time remains prior to system close to allow a timely report, the member may report the transaction the next day at system open designated "as/of."

(B) Members have an ongoing obligation to report transaction information promptly, accurately, and completely. The member may employ an agent for the purpose of submitting transaction information; however, the primary responsibility for the timely, accurate, and complete reporting of transaction information remains the non-delegable duty of the member obligated to report the transaction.

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

(A) Reports of transactions in TRACE-eligible 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."

(B) Reports of transactions in TRACE-eligible 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.

(b) Which Party Reports Transaction

Trade data input obligations are as follows:

(1) In transactions between two members, both members shall submit a trade report to TRACE;

(2) In transactions involving a member and a non-member, including a customer, the member shall submit a trade report to TRACE.

(c) Transaction 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;

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(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 the TRACE rules or the TRACE users guide; and

(13) Yield as required by SEC Rule 10b-10.

(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) For in-house cross transactions, report 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 required to be reported:

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

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

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

(f) Compliance With Reporting Obligations

A pattern or practice of late reporting without exceptional circumstances may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Rule 2110.

6240. Termination of TRACE Service

The Association may, upon notice, terminate TRACE service to a member in the event that a member 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.

6250. Dissemination of Corporate Bond Trade Information

(a) Immediately upon receipt of transaction reports between 8:00 a.m. and 6:30 p.m. Eastern Time, the Association will disseminate transaction information (except that market aggregate information and last sale information will not be updated after 5:15 p.m.) relating to transactions in:

(1) a TRACE-eligible security having an initial issuance size of \$1 billion or greater that is Investment Grade at the time of receipt of the transaction report; and

(2) a security that is denominated as a "Fixed Income Pricing System (FIPS)" security under NASD Rules relating to FIPS securities immediately prior to the time that such rules are rescinded.

(b) All trade reports in TRACE-eligible securities approved for dissemination and submitted to TRACE prior to 5:15 p.m. Eastern Time 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,

(3) trades in baby bonds with a par value of less than \$1,000, or

(4) trades in which the price is determined by a weighted average.

(c) Reports of transactions in TRACE-eligible securities executed after 6:30 p.m. Eastern Time and before 12:00 a.m. Eastern Time that are reported pursuant to Rule 6230(a)(2)(A) on the next day and designated "as/off" will not be included in daily market aggregates and will be disseminated beginning at 8:00 a.m. Eastern Time on the day of receipt.

(d) Reports of transactions in TRACE-eligible securities executed after 12:00 a.m. Eastern Time and before 8:00 a.m. Eastern Time and reported that same day beginning at 8:00 a.m. Eastern Time pursuant to Rule 6230(a)(2)(B) will be included in that day's market aggregates and disseminated upon receipt.

6260. Lead Underwriter Information Obligation

In order to facilitate trade reporting of secondary transactions in TRACE-eligible securities, the member that is the lead underwriter of any newly issued TRACE-eligible 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.

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