June 24, 2002

By Messenger and Electronic Mail

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **Response to Comments and Amendment No. 2 to File No. SR-NASD-2002-46 Proposed Amendments to NASD Rule 6200 Series ("TRACE Rules")**

Dear Ms. England:

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934 (" Exchange Act"), NASD is filing with the Securities and Exchange Commission ("SEC" or "Commission") this response to comments and Amendment No. 2 to SR-NASD-2002-46 relating to the new Rule 6200 Series (or "TRACE Rules"). The TRACE Rules provide for the reporting of transactions, and dissemination of transaction information, in TRACE-eligible debt securities.[1] In Amendment No. 2, NASD proposes to extend the deadline for a member to notify NASD of the Committee on Uniform Securities Identification Procedures numbers ("CUSIP numbers") of new securities in Rule 6260 if the member is engaged in certain underwritings that occur within one day. The NASD also proposes to amend Rule 6260 to require members to provide certain descriptive information relating to the security when providing the CUSIP number to the NASD. The text of the proposed rule change is set forth in attached Exhibit 1.

NASD received one comment letter on SR-NASD-2002-46.[2] The comments raised several issues. NASD's response is set forth below.

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[1] The SEC has approved the new Rule 6200 Series, but the rules have not yet taken effect. The rules will become effective on July 1, 2002. The SEC initially approved the rules on January 23, 2001. File No. SR-NASD-1999-65, Securities Exchange Act Release No. 43873 (Jan. 23, 2001), 66 FR 8131 (Jan. 29, 2001) (approval order). The SEC approved additional amendments to the rules on March 5, 2001 and December 13, 2001. File Nos. SR-NASD-2001-04, Securities Exchange Act Release No. 44039 (March 5, 2001), 66 FR 14234 (March 9, 2001) (approval order) and SR-NASD-2001-91, Securities Exchange Act Release No. 45229 (Jan. 3, 2002), 67 FR 1255 (Jan. 9, 2002) (notice of proposed rule and immediate effectiveness upon filing on December 13, 2001, and approval order).

[2] Comment letter from Michel de Konkoly Thege, Vice President and Associate General Counsel, The Bond Market Association ("TBMA"), to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated June 12, 2002 ("TBMA Comment Letter").

I. Response to Comments

Definition of "Money Market Instrument" in Rule 6210(a)

Money market instruments are one of a few types of securities that are explicitly excluded from the definition of "TRACE-eligible security." To more clearly define the term, NASD proposed that, for purposes of the TRACE Rules, a money market instrument would be defined as "a debt security that at issuance has a maturity of one year or less." The commenter urged NASD to define "money market instrument" to track the definition of "Eligible Security" as defined in Rule 2a-7(a)(10) under the Investment Company Act of 1940 ("Investment Company Act").[3]

NASD does not believe that it is appropriate to revise the definition of money market instrument in the TRACE Rules to track the definition of "Eligible Security" under Rule 2a-7(a)(10). First, the definition of "Eligible Security" is quite complex, making use of the definition is inconsistent with NASD's goal to clearly delineate those securities subject to the TRACE Rules.[4] In addition, with respect to a particular security, Rule 2a-7(a)(10) applies differently over time. For example, the definition in Rule 2a-7(a)(10) may apply to long and medium term securities as they approach maturity. Under the definition proposed by NASD, eligibility (or, in this case, ineligibility) under TRACE requires a single determination for the life of the security. Thus, applying the definition in Rule 2a-7 would not clarify or simplify a determination of whether a debt instrument is TRACE-eligible or excluded as a money market instrument and would not make it consistent with instruments that are eligible for money market funds. In addition, the term "Eligible Security" in the Investment Company Act and the term "TRACE-eligible security" in the TRACE Rules are applied in different contexts. The Investment Company definition is a construct that applies to a mix of securities with a variety of maturities and was adopted from the perspective of balancing an entire portfolio of instruments, to achieve, overall, an investment vehicle that reflected money market rates of returns and risks. This approach is not appropriate in analyzing a particular security and determining, based on its characteristics at issuance, if transactions in the security should be included or excluded from the regulatory audit trail for over-the-counter debt transactions and, at a later date, included or excluded from dissemination.

Rule 6210(e), "Parties to the Transaction"

The commenter states that NASD's exclusion of clearing brokers from the defined term, "parties to the transaction," is unclear. NASD excluded "clearing broker" from the definition to indicate

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[3] Rule 2a-7 under the Investment Company Act is entitled "Money Market Funds."

[4] The definition of "Eligible Security" is set forth in 9 subparagraphs and incorporates nine other terms defined in Rule 2a-7 (e.g., Rated Security, Unrated Security, Asset Backed Security, Municipal Issuer, Requisite NRSRO, Guarantee, Special Purpose Entity, Demand Feature, Government Security). In addition, each of these defined terms may incorporate the same or additional defined terms (e.g., "Rated Security" has three subparagraphs and incorporates three defined terms).

that a broker that merely clears a transaction does not have a reporting obligation under the TRACE Rules. For purposes of TRACE, a broker that performs only a clearing function is not considered a party to the transaction and should not submit a transaction report, unless the broker has also performed the executing function, or the clearing broker is reporting a transaction for an actual party to the transaction pursuant to an agreement to do so (e.g., where a clearing broker, pursuant to a privately negotiated agreement with a correspondent, reports on behalf of the correspondent whenever the correspondent has a reporting obligation under TRACE).

Rule 6230(c)(13), Yield

The commenter states that requiring a party to report the lower of yield to call or yield to maturity is “confusing.” NASD believes that requiring the reporting of the lower of these two yields is appropriate and necessary for the protection of investors and the integrity of the debt markets. The data reported for each trade as “yield” must be comparable to the data to: (1) inform buyers and sellers, including public investors, of the price and yield of comparable debt securities; and (2) create an audit trail in which the price and yield of all transactions can be compared. NASD is requiring that a party report the lower of yield to call or yield to maturity because such yields are the benchmarks for comparing bonds.

Rule 6230(d), Reporting of Agency Transactions

The commenter expressed concern that NASD’s proposal forces reporting firms to incur unnecessary expenses by requiring that transactions, including the two transactions that occur in an “agency cross,” must be reported separately. The TRACE Rules have required the reporting of each transaction. The requirement that both transactions be reported individually is in furtherance of a regulatory goal. The TRACE system was so designed based on input from market surveillance and market regulation personnel. It was determined that, in some instances, “single” trade reporting may raise issues and creates gaps in the regulatory audit trail. In creating a new bond reporting system, NASD determined not to incorporate certain features that may hinder the creation of a complete audit trail and therefore hinder efficient oversight of the market. For these reasons, NASD determined that the agency cross transaction should be reported as two transactions.

Proposed Amendment to Rule 6260 For Shelf And Other Intra-Day Offerings

Current Rule 6260, as approved by the SEC on January 23, 2001, provides that a 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.” (The TRACE system is coded to recognize a specific CUSIP number. If the CUSIP has not been entered into the TRACE system, it will reject the transaction report, even if the security is a TRACE-eligible security. The TRACE system is designed to be updated nightly after 5:00 p.m. with new CUSIP numbers.)

In Amendment No. 1 to this rule filing, NASD proposed to amend Rule 6260 to provide that "the managing underwriter of any newly issued TRACE-eligible security shall obtain the CUSIP number and provide it to the TRACE Operations Center not later than 5:00 p.m. on the business day preceding the day that the registration statement will become effective, or, if registration is not required, the day that the securities will be priced initially." The deadline for providing CUSIPs was *moved back to immediately precede the actual offering day* to address regulatory concerns that the audit trail, especially for those bonds that trade infrequently after the initial offering, would contain substantial gaps if the underwriter was not required to provide the CUSIP until the end of the first day of trading, with the result that all first day trading would not be reported.[5] In addition, price transparency would be reduced because the first day of trading in a debt security is often its most active day. This requirement (hereinafter, the "Prior Day CUSIP Notification") was published in the Federal Register for notice and comment on May 22, 2002.[6]

NASD withdraws the specific text of Rule 6260 submitted in Amendment No. 1; for clarity, NASD is reorganizing and restating the provisions of Amendment No. 1 in this Amendment No. 2. In addition, in response to comments, NASD is proposing an exception to the Prior Day CUSIP Notification in Rule 6260 for intra-day offerings. (These offerings are generally referred to as "off-the-shelf" or "shelf" offerings.) When securities are previously registered under Rule 415 of the Securities Act of 1933 ("Securities Act") or are unregistered securities that may be resold pursuant to Rule 144A of the Securities Act,[7] an issuer and an underwriter may decide to take advantage of favorable market conditions and offer the issuer's debt securities on that day. When such intra-day offerings occur, it would be impossible for an underwriter to price, offer and sell such securities and comply with the Prior Day CUSIP Notification. It is not NASD's intent to inhibit same-day access to the capital markets. Therefore, NASD proposes to except from the Prior Day CUSIP Notification intra-day unregistered offerings followed by Rule 144A resales and shelf offerings. In such offerings, the underwriter must obtain the CUSIP number and provide it to the TRACE Operations Center not later than 5:00 p.m. on the business day that the securities have been sold initially. The change will allow NASD to balance the interests of

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5 Previously, on April 2, 2002 in response to industry concerns, NASD proposed that Rule 6260 be modified to require the managing underwriter (or, if no managing underwriter was appointed, the group of underwriters) to provide the CUSIP numbers for newly issued TRACE-eligible securities *not later than 5:00 p.m. on the first business day following the day the registration statement became effective (or, if registration was not required, the day that the securities were first priced.* See SR-NASD-2002-46, filed on April 2, 2002. This provision was superseded because NASD and other regulators expressed concern that an additional 24 hour delay in capturing trades would create gaps in the audit trail that might impede proper surveillance of the debt securities markets. Ultimately, these concerns outweighed NASD's desire to provide market participants an additional 24 hours to provide CUSIP numbers to NASD (and the limited circumstances wherein such additional time was actually required in order to comply with Rule 6260).

6 Securities Exchange Act Release No. 45943 (May 16, 2992); 67 FR 36049 (May 22, 2002).

7 17 C.F.R. 230.415; 17 C.F.R. 230.144A.

issuers in obtaining expedited, well-timed access to the capital markets and those of investors in collecting a more complete audit trail (and, when dissemination occurs, obtaining more complete price information). (See Exhibit 1.)

In Amendment No. 2, NASD also is proposing to amend Rule 6260 to require the underwriter to provide information in addition to the CUSIP number to the TRACE Operations Center. The additional information is the issuer's name, the coupon rate of the security, the maturity, Rule 144A applicability, and a brief description of the issue (e.g., senior subordinated note, senior note). The information will allow the TRACE Operations Center to compare the CUSIP and related information about the security with information available from vendors, and verify that the CUSIP numbers are accurate before NASD disseminates the CUSIP numbers to the industry that night. NASD will make the final determination whether a debt security is TRACE-eligible. (See Exhibit 1.)

The commenter also asked that NASD address and clarify certain interpretive issues, which include TRACE eligibility questions, the trade reporting obligations of broker-dealers that are alternative trading systems ("ATSs"), the identification of transactions that do not reflect secondary market pricing, and others. These and other interpretive issues will be addressed in Notices to Members. In addition, the commenter requested that NASD address several operational and technical issues, and to respond to contractual and testing issues in a manner that would notify the entire industry. NASD addresses the operational, technical and testing issues raised in the comment letter on the TRACE website, which is www.nasd.com/trace.asp. NASD has responded to issues raised in agreements by revising its agreements.

II. Statutory Basis and Burden on Competition

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Exchange Act, which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and in general, to protect investors and the public interest. NASD's proposed rule change, if approved, will establish rules for the reporting and dissemination of information on eligible debt securities transactions that will provide NASD, as the self-regulatory organization designated to regulate the over-the-counter markets, with heightened capabilities to regulate the fixed income markets in order to prevent fraudulent and manipulative acts and practices. The proposed structure to collect the information, with NASD acting as the proposed consolidator of such information, is consistent with the requirements of the Exchange Act and will foster cooperation and coordination with persons engaging in regulating, clearing, settling, and processing of information with respect to debt securities and among persons facilitating transactions in debt securities. The proposed rule change, by requiring reporting and dissemination of such transaction information, will protect investors and the public interest by, among other things, increasing transparency in the debt markets.

NASD believes that the amended proposal imposes no burden on competition not necessary and appropriate in furtherance of the purposes of the Exchange Act.

III. Accelerated Approval of Amendment No. 2

NASD requests that the Commission find good cause pursuant to Section 19(b)(2) of the Exchange Act to approve proposed Amendment No. 2 prior to the 30th day after publication in the Federal Register. Rule 6260 would require most but not all underwriters to provide CUSIP numbers to NASD by 5:00 p.m. Eastern Time on the business day prior to the initial sale of securities. This Prior Day CUSIP Notification was previously published and subject to comment. The proposed exception to the Prior Day CUSIP Notification provides that underwriters that are offering securities on an intra-day basis shall provide CUSIP numbers to NASD not later than 5:00 p.m. Eastern Time on the same day that pricing and sales occur. Although not previously published, the proposal is an appropriate and narrowly drafted exception to the previously published proposal and responds to the concerns that Rule 6260 would negatively impact issues that are offered and sold in the market on an intra-day basis. Moreover, the revisions will permit TRACE to capture nearly all the debt securities transactions that it would have captured without the proposed change. (All other underlined or deleted changes in the text of the rule were proposed in previous filings relating to Rule 6260 and have been subject to notice and comment; the language was restated in the amendment for clarity.)

NASD is also proposing that an underwriter supply to the TRACE Operations Center, in addition to the CUSIP number for each newly issued security, the issuer's name, the coupon rate, the maturity, a brief description of the security and whether the issue is being resold pursuant to Rule 144A. Each of these items is within the issuer's documentation and easily provided. NASD believes that the acceleration of the approval of this provision is necessary to protect customers and the integrity of the audit trail. NASD will use the information to promptly determine if the CUSIP numbers submitted are accurate before NASD loads the new CUSIP numbers in the TRACE system the same evening and transmits such numbers to the industry. If the CUSIP numbers are inaccurate, transaction activity will be incorrect either because a report reflects the wrong security or a report was rejected by the TRACE system. For these reasons, the proposed requirement in Rule 6260 for such additional information should be approved on an accelerated basis.

IV. Consent to Extension

At the request of the staff of the SEC, the NASD hereby consents to an extension of two days of the period for Commission action under Section 19(b)(2) of the Exchange Act on the proposed rule change.

If you have any questions, please contact Sharon K. Zackula, Assistant General Counsel, Office of General Counsel, NASD, at (tel) 202-728-8985; (fax) 202-728-8264; or (e-mail) sharon.zackula@nasd.com.

Very truly yours,

T. Grant Callery
Senior Vice President and
General Counsel

Exhibit 1

cc: Stephen Williams
Gordon Fuller
Mary Simpkins

EXHIBIT 1

Below is the text of the proposed rule change. The text of Rule 6260 is marked to show changes from current Rule 6260. New language is underlined and deletions are bracketed.

6200. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)

6260. [Lead] Managing Underwriter [Information] Obligation To Obtain CUSIP

(a) In order to facilitate trade reporting of secondary transactions in TRACE-eligible securities, the member that is the [lead] managing underwriter of any newly issued TRACE-eligible security [shall] must obtain and provide information to the TRACE Operations Center as required under paragraph (b). If a managing underwriter is not appointed, the group of underwriters must comply with paragraph (b).

(b) For such TRACE-eligible securities, the managing underwriter must provide to the TRACE Operations Center: (1) the CUSIP number; (2) the issuer name; (3) the coupon rate; (4) the maturity; (5) whether Rule 144A applies; and (6) a brief description of the issue (e.g., senior subordinated note, senior note). The managing underwriter must obtain the CUSIP number and provide it and the information listed as (2) through (6) not later than 5:00 p.m. on the business day preceding the day that the registration statement becomes effective, or, if registration is not required, the day before the securities will be priced. If an issuer notifies an underwriter, or the issuer and the underwriter determine, that the TRACE-eligible securities of the issuer shall be priced, offered and sold the same business day in an intra-day offering under Rule 415 of the Securities Act of 1933 or Rule 144A of the Securities Act of 1933, the member shall provide the information not later than 5:00 p.m. on the day that the securities are priced and offered. A member must make a good faith determination that the security is a TRACE-eligible security before submitting the information to the TRACE Operations Center.[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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