

February 13, 2004

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

Re: File No. SR-NASD-2003-182 – Consent to Extension of Time and Response to Comments on Proposed Amendments to “TRACE-Eligible Security”

Dear Ms. England:

In SR-NASD-2003-182, NASD proposes changes to Rule 6210 and Rule 6230, which are part of the Trade Reporting and Compliance Engine rules (“TRACE Rules”). NASD hereby consents to an extension of time for Securities and Exchange Commission (“SEC”) action on SR-NASD-2003-182 to March 1, 2004. At the SEC staff’s request, NASD also is responding to the comments submitted to the SEC in response to the publication of the rule filing.¹ The commenters raised two issues, as further discussed below.²

1. Exemption for Certain Securities Listed and Quoted on Nasdaq

One commenter raised concerns about expanding the exemption from trade reporting for certain transactions in TRACE-eligible securities that are also listed and quoted on Nasdaq.³ NASD currently does not require a member to report a transaction to TRACE in a convertible debt security that is a TRACE-eligible security that is listed and quoted on Nasdaq, when the transaction is reported to Nasdaq and the transaction information is publicly disseminated.⁴ The commenter indicated that the exemption from

¹ See Securities Exchange Act Release No. 48926 (December 15, 2003), 68 FR 71207 (December 22, 2003).

² Letter from Michele C. David, Vice President and Assistant General Counsel, The Bond Market Association, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated January 16, 2004 (“TBMA Letter”); email letter from Paul Scheurer to rule-comments@sec.gov, dated January 12, 2004 (“Scheurer Letter”).

³ See Scheurer Letter.

⁴ Rule 6230(e)(2). A similar exemption applies to debt securities that are listed on a national securities exchange when the transaction is executed on and reported to the national securities exchange, and the transaction information is publicly disseminated.

trade reporting to TRACE should not be broadened to include transactions in *all* TRACE-eligible debt securities listed on Nasdaq (rather than only convertible debt securities) and otherwise meeting the conditions for the exemption unless Nasdaq's bond reporting system was equal in quality to the TRACE system.

NASD developed this particular exemption because a convertible debt security that is listed and quoted on Nasdaq must be reported to Nasdaq via the Automated Confirmation Transaction Service ("ACT") under the Rule 4650 Series. As a preliminary matter, there currently are very few debt securities that are listed on Nasdaq, and only some of the transactions occurring in those securities would meet all of the conditions for the exemption and thus not be reported to TRACE. More importantly, while there are certain differences between TRACE and ACT in the reporting and dissemination of debt securities transactions, NASD does not believe that requiring members to report a transaction to both TRACE and ACT results in a measurable enhancement to investor protection or market integrity. For example, Rule 6230 requires that both sides of a transaction report the transaction to TRACE (if both are NASD members) and the Rule 4650 Series requires that only one member report such a transaction to ACT; however, the Rule 4650 Series further requires that a transaction be reported to ACT within 90 seconds, whereas Rule 6230 provides members with 45 minutes to report the transaction to TRACE.⁵ As the rules currently stand, NASD does not believe that it is beneficial to require a transaction that will be reported to ACT in 90 seconds also to be reported to TRACE.

Scope of the Definition of TRACE-Eligible Security

The second commenter focused exclusively on NASD's proposal to amend a phrase in Rule 6210(a), which is the definition of "TRACE-eligible security."⁶ NASD proposes to amend the phrase, "United States and/or foreign private corporations," to

⁵ It should be noted that although the current reporting period is 45 minutes, NASD intends to file a proposed rule change to reduce the period to report a transaction to TRACE from 45 minutes to 30 minutes, and, thereafter, to 15 minutes.

⁶ See TBMA Letter.

read, "United States and/or foreign private issuers."⁷ NASD proposes to delete the word, "corporations," and replace it with "issuers" solely to clarify that the securities of issuers using forms of business organizations other than the corporate form are included in the definition of TRACE-eligible securities. Simply stated, it has long been the position of NASD – a position that is widely known by market participants -- that TRACE-eligible securities are not limited to debt securities issued by incorporated entities.

In this regard, NASD notes that it was always its intention that the universe of TRACE-reportable securities includes securities issued not only by corporations, but also by entities such as limited partnerships and trusts.⁸ This universe includes, among others, the securities that formerly were incorporated in the Fixed Income Pricing Service ("FIPS").⁹ At the earliest stages of development of the TRACE regulatory and reporting structure, it was understood by market participants and regulators alike that securities that

⁷ Specifically, NASD proposes to amend Rule 6210(a) to add the underlined text and to delete the bracketed text as follows:

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 issuers[corporations]; and: (1) registered under the Securities Act of 1933 [with the Securities and Exchange Commission] or (2) issued pursuant to Section 4(2) of the Securities Act of 1933 and purchased and sold pursuant to Rule 144A of the Securities Act of 1933. The term "TRACE-eligible security" excludes debt issued by government-sponsored entities, mortgage- or asset-backed securities, collateralized mortgage obligations, and money market instruments. For purposes of the Rule 6200 Series, the term "money market instrument" means a debt security that at issuance has a maturity of one year or less.

⁸ In first proposing the TRACE rules in SR-NASD-99-65, NASD stated its position 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 Corporation ("DTC"); (2) Rule 144A U.S. high-yield debt securities designated as "PORTAL Debt Securities" in Nasdaq's PORTAL Market; and (3) Rule 144A investment grade debt securities eligible for book-entry services at DTC. *For clarification, the securities described above would include: (a) . . . and (e) capital trust securities, floating rate notes and global bonds issued by U.S. companies and foreign private companies.*" Securities Exchange Act Release No. 42201 (December 3, 1999), 64 FR 69305, 69309 (December 10, 1999) (Notice of Filing and Request for Comments on SR-NASD-99-65) (italics added) (footnote omitted).

⁹ See Securities Exchange Act Release No. 32019 (March 19, 1993), 58 FR 16428 (March 26, 1993) (order approving SR-NASD-92-45, permitting NASD to establish and operate FIPS, to collect, process and disseminate, real-time, firm quotations for 30-50 of the most liquid high yield bonds, and approving rules requiring members to report transactions in all high yield bonds traded over-the-counter to FIPS for regulatory purposes).

were FIPS-eligible would become TRACE-eligible securities.¹⁰ Securities that were reportable to FIPS included capital trust, equipment trust, trust, and limited partnership securities. Although there were many comments filed on, and much discussion regarding, the establishment of the TRACE system, at no time did commenters suggest that certain FIPS-reported securities not be reported to TRACE because they were issued by, for example, a limited partnership or a trust.¹¹ NASD has identified more than 100 securities that were not issued by a corporation, were routinely reported to FIPS and that, if still traded at the initiation of TRACE, were incorporated in TRACE and subject to the TRACE requirements. *See* Exhibit A for examples of such securities.

¹⁰ See Securities Exchange Act Release No. 42201 (December 3, 1999), 64 FR 69305, 69310 (December 10, 1999) (Notice of Filing and Request for Comments on SR-NASD-99-65), in which NASD stated:

9. Fixed Income Pricing System

The rules of Nasdaq's 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 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 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.

¹¹ See Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131 (January 29, 2001) (SR-NASD-99-65) ("Adopting Release") (summarizing and addressing comments submitted on the TRACE proposal).

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Further, from the initiation of TRACE, members have in fact reported debt securities that are capital trust, equipment trust, trusts, and limited partnerships securities, as well as other types of securities, to TRACE. Although the current universe of TRACE-eligible securities is composed largely of securities issued by corporate issuers because it is the predominate form of large business operations, a number of securities in the universe of TRACE securities are securities issued by a limited partnership, a capital trust, an equipment trust, and other types of trusts, among others. It simply is well understood in the industry that debt securities of these issuers are included in the universe of TRACE-eligible securities.

The commenter expresses concern that the proposed clarification of the definition of "TRACE-eligible security" would require members to now report to TRACE a variety of "structured" or "asset-backed" securities that are not currently being reported to the system. NASD notes, however, that under Rule 6210(a), "asset-backed securities" are specifically excluded from the universe of TRACE-eligible securities. NASD is not seeking to amend that exclusion with this proposed rule change.

If you have any questions, please contact Sharon K. Zackula, Assistant General Counsel, Office of General Counsel-Regulatory Policy and Oversight ("RPO"), RPO, at (202) 728-8985; e-mail sharon.zackula@nasd.com, or Elliot Levine, Chief Counsel and Senior Advisor, Market Operations and Information Services, Regulatory Services and Operations, at (202) 728-8405; e-mail elliott.levine@nasd.com. The fax numbers of the Office of General Counsel and Market Operations and Information Services, are, respectively, (202) 728-8264 and (202) 858-4083.

Very truly yours,

Marc Menchel
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cc: Stephen L. Williams
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