

June 17, 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-2004-094 – Proposed Amendments to TRACE Rule 6250 and Related TRACE Rules to Disseminate Transaction Information on All TRACE-Eligible Securities and Facilitate Dissemination**

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Sharon Zackula, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8985; e-mail [sharon.zackula@nasd.com](mailto:sharon.zackula@nasd.com) or Elliot Levine, Chief Counsel and Senior Advisor, Markets, Services, and Information, at (202) 728-8405; email [elliott.levine@nasd.com](mailto:elliott.levine@nasd.com). The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Barbara Z. Sweeney  
Senior Vice President  
and Corporate Secretary

Enclosures

File No. SR-NASD-2004-094  
Consists of 70 Pages  
June 17, 2004

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C.

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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

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend: (1) Rule 6210 to amend two defined terms and add a new defined term; (2) Rule 6250 to expand dissemination to include all TRACE-eligible securities and to delete provisions regarding market aggregate and last sale data and the treatment of certain transaction reports; and (3) Rule 6260 to amend the notification provisions to require information needed to implement various dissemination schedules, and to make certain minor, technical changes. Rule 6210, Rule 6250 and Rule 6260 are part of the Transaction Reporting and Compliance Engine rules (“TRACE Rules”). NASD is also proposing that the amendments to Rule 6250 be implemented in two stages, and that not later than nine months after the implementation of the second stage, NASD review and consider the effects of the amendments to Rule 6250 on the trading of TRACE-eligible securities, and review the dissemination provisions then in effect.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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**Rule 6200. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)**

**Rule 6210. Definitions**

(a) through (g) No Change

(h) The term “Investment Grade” shall mean a TRACE-eligible security that, if rated by

only one nationally recognized statistical rating organization (“NRSRO”), is rated in one of the four highest generic rating categories; or if rated by more than one NRSRO, is rated in one of the four highest generic rating categories by all or a majority of such NRSROs; provided that if the NRSROs assign ratings that are evenly divided between (i) the four highest generic ratings and (ii) ratings lower than the four highest generic ratings, NASD will classify the TRACE-eligible security as Non-Investment Grade for purposes of TRACE. If a TRACE-eligible security is unrated, for purposes of TRACE, NASD may otherwise classify the TRACE-eligible security as an Investment Grade security and further classify it as being in one of the four highest generic rating categories.[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 a TRACE-eligible security that, if rated by only one NRSRO, is rated lower than one of the four highest generic rating categories; or if rated by more than one NRSRO, is rated lower than one of the four highest generic rating categories by all or a majority of such NRSROs. If a TRACE-eligible security is unrated, for purposes of TRACE, NASD may otherwise classify the TRACE-eligible security as a Non-Investment Grade security and further classify it as being in one of the generic rating categories below the four highest such categories. If NASD does not have sufficient information to make a judgment regarding the classification of an unrated TRACE-eligible security, for purposes of TRACE, NASD will classify the TRACE-eligible security as having been rated B (or the equivalent rating of one or more NRSROs).<sup>1</sup>[any TRACE-eligible security that is unrated, non-

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<sup>1</sup> “B” is a rating of Standard & Poor's, a division of the McGraw-Hill Companies, Inc. (“S&P”). S&P is a nationally recognized statistical rating organization. S&P's ratings are proprietary to S&P and are protected by copyright and other intellectual property laws. S&P's licenses ratings to NASD. Ratings may not be copied or

rated, split-rated (where one rating falls below Investment Grade), or otherwise does not meet the definition of Investment Grade in paragraph (h) above.]

(j) The term, “split-rated,” shall mean an Investment Grade or a Non-Investment Grade security that is assigned ratings by multiple NRSROs that, for an Investment Grade security, are not in the same generic Investment Grade rating category, or, for a Non-Investment Grade security, are not in the same generic Non-Investment Grade rating category. After determining if a security is Investment Grade or Non-Investment Grade, NASD will disregard any rating, if the security is Investment Grade, that is Non-Investment Grade, or, if the security is Non-Investment Grade, that is Investment Grade. With respect to an Investment Grade security, if multiple NRSROs assign ratings that are not in the same generic Investment Grade rating category, or, with respect to a Non-Investment Grade security, if multiple NRSROs assign ratings that are not in the same generic Non-Investment Grade rating category, NASD will classify the TRACE-eligible security for purposes of TRACE by the generic rating that a majority or, if no majority, a plurality of the NRSROs assigns the security, provided that (i) if the NRSROs assign ratings that are evenly divided between two generic rating categories, NASD will classify the TRACE-eligible security for purposes of TRACE by the lower of the ratings; or (ii) if each NRSRO assigns a different generic rating, NASD will classify the TRACE-eligible security for purposes of TRACE by the lower or lowest of the ratings.

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#### **6250. Dissemination of [Corporate Bond Trade]Transaction Information**

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otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed or resold, or stored for subsequent use for any such purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person without S&P's prior written consent.

**(a) Dissemination of New Issue Aftermarket Transactions**

(1) Transaction information for TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BBB (or the equivalent rating of one or more NRSROs) executed during the period beginning the day a newly issued security is priced and lasting two business days (“New Issue Aftermarket-2”) will not be disseminated during the New Issue Aftermarket-2. NASD will disseminate transaction information for transactions executed during the New Issue Aftermarket-2 starting on the next (third) business day, according to dissemination protocols established by NASD.

(2) Transaction information for TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower executed during the period beginning the day a newly issued security is priced and lasting 10 business days (“New Issue Aftermarket-10”) will not be disseminated during the New Issue Aftermarket-10. NASD will disseminate transaction information for transactions executed during the New Issue Aftermarket-10 starting on the next (eleventh) business day, according to dissemination protocols established by NASD.

**(b) Dissemination of Secondary Market Transactions**

(1) Immediate Dissemination. NASD will disseminate transaction information immediately upon receipt of a transaction report, if the report is for a transaction:

(A) In a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE above BBB (or the equivalent rating of one or more NRSROs); or

(B) In a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as BBB (or the equivalent rating of one or more NRSROs) executed other than during the New Issue Aftermarket-2; or,

(C) In a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower executed other than during the New Issue Aftermarket-10 if:

(i) the size of the transaction is \$1 million or less (par value);

or

(ii) the size of the transaction is greater than \$1 million (par value), and the TRACE-eligible security is traded (a) an average of one or more times per day, during the New Issue Aftermarket-10; and (b) thereafter, an average of one or more times per day over the last 20 business days of a 90-day period determined each quarter by NASD. Such security shall remain subject to immediate dissemination until such 90-day period in which the security fails to meet the condition set forth in this

subparagraph (C)(ii)(b), in which case it shall be subject to a two-or four-business day delayed dissemination, as applicable.

(2) Two- or Four-Business-Day Delayed Dissemination. For transactions in a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower executed other than during the New Issue Aftermarket-10, NASD will disseminate transaction information on a two- or four-business-day delayed basis from the time of execution as follows:

(A) Two-Business-Day Delay. In a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) if:

(i) the size of the transaction is greater than \$1 million (par value); and

(ii) the security is traded (a) an average of less than one time per day, during the New Issue Aftermarket-10; and (b) thereafter, an average of less than one time per day over the last 20 business days of a 90-day period determined each quarter by NASD. Such security shall remain subject to a two-business day delayed dissemination until such 90-day period in which the security fails to meet the condition set forth in this subparagraph (A)(ii)(b), in which case it shall be subject to immediate dissemination.

(B) Four-Business-Day Delay. In a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as B (or the equivalent rating of one or more NRSROs) or lower if:

- (i) the size of the transaction is greater than \$1 million (par value) and;
- (ii) the security is traded (a) an average of less than one time per day, during the New Issue Aftermarket-10; and (b) thereafter, an average of less than one time per day over the last 20 business days of a 90-day period determined each quarter by NASD. Such security shall remain subject to a four-business day delayed dissemination until such 90-day period in which the security fails to meet the condition set forth in this subparagraph (B)(ii)(b), in which case it shall be subject to immediate dissemination.

**(b) Rule 144A**

NASD will not disseminate information on a transaction in a TRACE-eligible security that is issued pursuant to Section 4(2) of the Securities Act of 1933 and resold pursuant to Rule 144A under the Securities Act of 1933.

**[(a) General Dissemination Standard**

Immediately upon receipt of transaction reports received at or after 8:00 a.m. through 6:29:59 p.m. Eastern Time, NASD will disseminate transaction information (except that market aggregate information and last sale information will not be updated after 5:15 p.m. Eastern Time) in the securities described below.

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

(2) A TRACE-eligible security that is Non-Investment Grade at the time of receipt of the transaction report and is designated by NASD for dissemination according to the following criteria.

(A) The staff of NASD will designate fifty of the most actively traded Non-Investment Grade securities that are TRACE-eligible securities for dissemination under this rule, based on (i) the security's volume; (ii) the security's price; (iii) the security's name recognition; (iv) the research following of the security; (v) the security having a minimum number of bonds outstanding; (vi) the security being traded routinely by at least two dealers; and (vii) the security contributing to a representation of diverse industry groups in the group of securities designated for dissemination.

(B) A Non-Investment Grade security will not be designated, and may be immediately withdrawn from designation, for dissemination under this rule if the security: (i) has matured; (ii) has been called; (iii) has been upgraded to Investment Grade; or (iv) has been downgraded to an extent that the security's trading characteristics do not warrant designation for dissemination.

(3) A TRACE-eligible security that is Investment Grade, is rated by Moody's Investors Service, Inc. as "A3"<sup>1</sup> or higher, and by Standard & Poor's, a division of McGraw Hill Co., Inc., as "A-"<sup>2</sup> or higher, and has an original issue size of \$100 million or greater. If a security is rated under this provision to qualify for dissemination at any time on or after the effective date of the

rule, dissemination of transaction information on the security will continue under this paragraph unless the security is downgraded below Baa3/BBB-.

[<sup>1</sup> Moody's Investors Service, Inc. ("Moody's") is a nationally recognized statistical rating organization. Moody's is a registered trademark of Moody's Investors Service. Moody's ratings are proprietary to Moody's and are protected by copyright and other intellectual property laws. Moody's licenses ratings to NASD. Ratings may not be copied or otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed or resold, or stored for subsequent use for any purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person without Moody's prior written consent.]

[<sup>2</sup> Standard & Poor's, a division of the McGraw-Hill Companies, Inc. ("S&P"), is a nationally recognized statistical rating organization. S&P's ratings are proprietary to S&P and are protected by copyright and other intellectual property laws. S&P's licenses ratings to NASD. Ratings may not be copied or otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed or resold, or stored for subsequent use for any such purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person without S&P's prior written consent.]

(4) Ninety to 120 TRACE-eligible securities designated by NASD that are rated "Baa/BBB" at the time of designation, according to the following standards.

(A) Three groups, each composed of up to 50 TRACE-eligible securities (Group 1, Group 2, and Group 3), but collectively not exceeding 120, shall be designated by NASD. At the time of designation, each TRACE-eligible security in Group 1 must be rated "Baa1/BBB+" and each TRACE-eligible security in Group 2 and Group 3, must be rated, respectively, "Baa2/BBB" and "Baa3/BBB-." If a TRACE-eligible security is rated one of the "Baa" ratings by Moody's and one of the "BBB" ratings by S&P and the ratings indicate two different levels of credit quality, the lower of the two ratings will be used to determine the group to which a debt security will be assigned under this paragraph (a)(4).

(B) A TRACE-eligible security that has a rating from only one rating agency will not be designated under paragraph (a)(4).

(C) Dissemination of transaction information on a TRACE-eligible security that is designated under paragraph (a)(4) will not be discontinued if one rating is, or both ratings, are downgraded or upgraded.]

**[(b) Transactions Excluded From Market Aggregate, Last Sale**

All trade reports in TRACE-eligible securities that are approved for dissemination and submitted to TRACE at or after 8:00 a.m. Eastern Time and 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;
- (4) trades in which the price is determined by a weighted average price; and
- (5) trades in which the price is a "special price," as indicated by the use of the special price modifier.]

**[(c) Dissemination of Certain Trades Executed on A Business Day**

(1) Reports of transactions in TRACE-eligible securities that are subject to dissemination, are executed on a business day at or after 6:30 p.m. Eastern Time through 11:59:59 p.m. Eastern Time, and are reported pursuant to Rule 6230(a)(2) on the next business day and designated "as/of" will be disseminated beginning at 8:00 a.m. Eastern Time on the day of receipt. The reported information will not be included in the calculation of the day's market aggregates.

(2) Reports of transactions in TRACE-eligible securities that are subject to dissemination, are executed on a business day at or after 12:00 a.m. Eastern Time through 7:59:59 a.m. Eastern Time, and are reported pursuant to Rule 6230(a)(3) on the same day beginning at 8:00 a.m. Eastern Time will be disseminated upon receipt. The reported information will be included in the calculation of the day's market aggregates, except as otherwise provided in Rule 6250(b)(1) through (5).]

**[(d) Dissemination of Trades Executed on Non-Business Days**

Reports of transactions in TRACE-eligible securities that are subject to dissemination, are executed on a non-business day at any time during the day, and are reported pursuant to Rule 6230(a)(4) on the next business day will be disseminated upon receipt. The reported information will not be included in the calculation of the day's market aggregates.]

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**Rule 6260. Managing Underwriter or Group of Underwriters Obligation To Obtain CUSIP and Provide Notice**

**(a) Members Required to Provide Information and Notice**

(1) In order to facilitate trade reporting and dissemination of secondary transactions in TRACE-eligible securities, the member that is the managing underwriter or the members that are the group of underwriters of a distribution or offering, excluding a secondary distribution or offering, of a debt security that, upon issuance will be a TRACE-eligible security (“new issue”),[of any newly issued TRACE-eligible security] must obtain and provide information [by email or facsimile]to the TRACE Operations Center as required below.[under paragraph (b).] If a managing underwriter is not appointed, the group of underwriters must provide the information required under this rule.[comply with paragraph (b).]

(2) The information must be provided by facsimile or e-mail.

**(b) Notices**

For such [TRACE-eligible securities]new issues, the managing underwriter or group of underwriters must provide to the TRACE Operations Center[, by email or facsimile]: (1) the CUSIP number; (2) the issuer name; (3) the coupon rate; (4) the maturity; (5) whether Rule 144A applies; (6) a brief description of the issue (e.g., senior subordinated note, senior note); and, (7) information, as determined by NASD, [that is required to determine ]to implement the provisions of Rule 6250(a) and such other information NASD deems necessary to properly implement the reporting and

dissemination of a TRACE-eligible security[if a TRACE-eligible security must be disseminated under Rule 6250 (e.g., size of issue and rating)], or if any of items (2) through (7) has not been determined, such other information as NASD deems necessary. The managing underwriter or group of underwriters must obtain the CUSIP number and provide it and the information listed as (2) through (7) not later than 5:00 p.m. Eastern Time 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 a managing underwriter or group of underwriters, or the issuer and the managing underwriter or group of underwriters 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 Section 4(2) and Rule 144A of the Securities Act of 1933, the managing underwriter or group of underwriters shall provide the information not later than 5:00 p.m. Eastern Time on the day that the securities are priced and offered, provided that if such securities are priced and offered on or after 5:00 p.m. Eastern Time, the managing underwriter or group of underwriters shall provide the information not later than 5:00 p.m. Eastern Time on the next business day. The managing underwriter or group of underwriters must make a good faith determination that the security is a TRACE-eligible security before submitting the information to the TRACE Operations Center.

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(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Governors of NASD at its meeting on April 22, 2004, which authorized the filing of the rule change with the SEC. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

NASD proposes to implement the proposed rule change in two stages. NASD will implement the following portions of the proposed rule change as stage one ("Stage One"): the proposed amendments to Rule 6210 (definitions); Rule 6250(b)(1)(A) and (B), requiring immediate dissemination of all Investment Grade TRACE-eligible securities transactions, except transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BBB (or the equivalent rating of one or more NRSROs) that occur during a New Issue Aftermarket-2, as described in greater detail below; under Rule 6250(b)(1)(C)(i), all TRACE-eligible securities transactions of \$1 million or less (par value) subject to dissemination, except those where the subject security does not meet the frequency standard set forth in Rule

6250(b)(1)(C)(ii);<sup>2</sup> Rule 6250(b)(1)(C)(ii), requiring immediate dissemination of all transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower that exceed \$1 million (par value) and meet the frequency test set forth in this subsection; Rule 6250(c), prohibiting the dissemination of Rule 144A transactions; and Rule 6260, providing for new issue notifications. In addition, Stage One will include the proposed deletions of current Rule 6250(a) through (d).

The second stage (“Stage Two”) will consist of the implementation of proposed Rule 6250(a), providing for delayed dissemination of transaction information for transactions occurring during a New Issue Aftermarket-2 or New Issue Aftermarket-10, as described below; the portion of proposed Rule 6250(b)(1)(C)(i) not fully implemented in Stage One;<sup>3</sup> and proposed Rule 6250(b)(2), providing for delayed dissemination of transaction information in certain transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for

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<sup>2</sup> Rule 6250(b)(1)(C)(i) provides for the immediate dissemination of transactions in TRACE-eligible securities that are rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower and are executed other than during the New Issue Aftermarket-10, if the size of the transaction is \$1 million or less. NASD intends to partially implement this provision in Stage One. In Stage One, NASD proposes to disseminate immediately such transactions in *any security* for which the larger transactions (i.e., “\$1 million plus” transactions) are also disseminated in Stage One (i.e., securities that are traded an average of one or more times per day, as more fully set forth in Rule 6250(b)(1)(C)(ii)). Securities transactions described in Rule 6250(b)(1)(C)(i) that would otherwise be subject to immediate dissemination, but occurred in a security that was traded an average of less than one time per day and is subject to the delayed dissemination provisions in Rule 6250(b)(2)(A)(ii) or Rule 6250(b)(2)(B)(ii), will be disseminated in Stage Two, when delayed dissemination is functional and all transactions in the security will be disseminated. For example, XPL Security is rated BB (or the equivalent rating of one or more NRSROs) and trades an average of less than one time per day. Under Rule 6250(b)(1)(C)(i), a transaction in XPL Security for \$100,000 would be disseminated immediately if not for the above approach to implementation, but a transaction on the same day in XPL Security for \$2 million would not be disseminated at any time during Stage One. NASD intends to withhold the dissemination of the \$100,000 transaction in XPL Security during Stage One because it believes that all market participants will be best served and get a more complete and accurate indication of price when transactions of all sizes in a security are disseminated.

<sup>3</sup> See note 2, *supra*.

purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower.

NASD will implement Stage One on September 1, 2004, and will announce the effective date in a Notice to Members to be published no later than 60 days following Commission approval. NASD will implement Stage Two on December 1, 2004, and will announce the effective date in a second Notice to Members.

(b) Questions regarding this rule filing may be directed to Sharon K. Zackula, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight Division, at (202) 728-8985 or Elliot Levine, Chief Counsel and Senior Advisor, Market Operations and Information Services, Markets, Services, and Information Division, at (202) 728-8405.

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

(a) Purpose

I. Introduction and Background

In this proposed rule change, NASD is proposing to amend Rule 6250 to disseminate publicly transaction information for secondary market transactions in all TRACE-eligible securities, and to make related amendments to Rule 6210 and Rule 6260 to facilitate dissemination. The proposed amendments will result in NASD disseminating all TRACE-eligible securities transactions, except transactions executed pursuant to Rule 144A under the Securities Act of 1933.<sup>2</sup> Implementation of the proposed rule change is estimated to result in

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<sup>4</sup> Under Rule 6230(e), certain types of transactions currently are exempt from reporting (and therefore dissemination) (e.g., qualifying transactions in TRACE-eligible securities that are listed on a national securities exchange, when such transactions are executed on and reported to the exchange and the transaction information is disseminated publicly, and a parallel exemption for qualifying transactions in TRACE-eligible securities that are listed on The Nasdaq Stock Market, Inc.), and will continue to be exempt from reporting (and dissemination) under the proposal.

immediate dissemination of approximately 99 percent of all transactions in TRACE-eligible securities and 95 percent of the par value traded in such securities. Information on certain transactions, however, will be disseminated on a delayed basis. NASD is also proposing to delete provisions regarding market aggregates, last sale data, and the treatment of certain transaction reports in Rule 6250.

NASD is also proposing amendments to Rule 6210 and Rule 6260. In Rule 6210, NASD is proposing to amend the definitions of “Investment Grade” and “Non-Investment Grade” and to add a new defined term, “split-rated.” In Rule 6260, NASD is proposing to amend the notification requirements, which will aid NASD in identifying new issues of TRACE-eligible securities and the dissemination protocols that apply to them.

NASD is also proposing that the proposed amendments to Rule 6250 regarding dissemination be implemented in two stages, Stage One and Stage Two, because certain aspects of the proposal providing for delayed dissemination will require significant operational and technical changes to NASD’s TRACE System. Finally, not later than nine months after the implementation of Stage Two, NASD will review and consider the effects of the amendments to Rule 6250 on the trading of TRACE-eligible securities, and review the dissemination provisions then in effect.

The dissemination proposal was developed in consultation with the Bond Transaction Reporting Committee (“BTRC”), an advisory committee to the NASD Board of Governors.<sup>5</sup> The primary role of the BTRC is to make recommendations to the NASD Board concerning the

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<sup>5</sup> The Committee is appointed by the NASD Board of Governors and has ten members. Five of the members were recommended by the staff of NASD and the other five were recommended by The Bond Market Association (“TBMA”).

dissemination of transaction information under TRACE for secondary market transactions in eligible corporate bonds. To develop this proposal, the BTRC and NASD staff analyzed significant amounts of TRACE transaction data and deliberated on various dissemination approaches.

Initial concerns of certain market participants focused on the possible impact that increased transparency may have on market liquidity. After extensive examination of approximately 18 months of TRACE data and review of two studies performed by an outside econometric team, NASD found no conclusive evidence that TRACE transparency has adversely affected liquidity. Accordingly, NASD believes full transparency is warranted. As noted above, the proposed rule change will result in dissemination of all public secondary market transactions in TRACE-eligible securities, with approximately 99 percent of total transactions and 95 percent of total par value traded being immediately disseminated.

However, there are two areas of possible concern where NASD currently believes that a more measured approach toward immediate dissemination is in the best interest of investors and the corporate bond market. First, both institutional investors and dealers have expressed concern that liquidity could be harmed by the immediate transparency of large transactions in Non-Investment Grade securities, and particularly in such securities that trade infrequently. Second, similar liquidity concerns were raised regarding the few transactions that are effected in the New Issue Aftermarket-2 or -10 for securities rated BBB or lower,<sup>6</sup> where reduced liquidity could

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<sup>6</sup> For purposes of this filing, “BBB,” a rating of Standard & Poors (“S&P”) or any other rating of S&P means the S&P rating and the equivalent ratings of Moody’s Investors Service, Inc. (“Moody’s”) and any other NRSRO whose rating may be used for purposes of TRACE. Currently, NASD administers the TRACE

potentially increase borrowing cost to issuers. Although there was no conclusive proof of harm to the market in these two areas, NASD believes that the measured approach reflected by the dissemination delays set forth in the proposed rule change will provide additional time to assess the impact of transparency on this small number of transactions.

NASD intends to continue to review the trading and the liquidity in TRACE-eligible securities during the implementation of Stages One and Two of the proposed rule change. As part of this review process, not later than nine months from the implementation of Stage Two, NASD will ask the BTRC to reconvene to review the rule and make recommendations to the NASD Board of Governors.

## II. The Dissemination Proposal

### Current Dissemination Requirements

In current Rule 6250, NASD requires the dissemination of transaction information for four categories of securities: (1) a TRACE-eligible security that is Investment Grade at the time of receipt of the transaction report and has an initial issuance size of \$1 billion or greater;<sup>7</sup> (2) approximately 50 Non-Investment Grade TRACE-eligible securities that are designated by NASD staff according to the criteria, including liquidity, set forth in Rule 6250(a)(2);<sup>8</sup> (3) any TRACE-eligible security that is Investment Grade, rated A or higher and has an original issue

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dissemination provisions based on the ratings of S&P's and Moody's. The use of a single rating in this rule filing is for the convenience of readers only.

<sup>7</sup> Rule 6250(a)(1).

<sup>8</sup> From time to time, the staff reviews and amends the list of 50 securities; in between such comprehensive reviews, securities may be called or the staff may delete certain securities that no longer meet the criteria, at times resulting in the dissemination of less than 50 securities. See Rule 6250(a)(2).

size of \$100 million or greater, unless downgraded below BBB;<sup>9</sup> and (4) approximately 120 TRACE-eligible securities rated BBB at the time they were designated for dissemination.<sup>10</sup> All current dissemination is “immediate”; NASD disseminates the transaction information as soon as it is reported to NASD.

Proposed Dissemination for Transactions During the New Issue Aftermarket

NASD is proposing that dissemination for TRACE-eligible securities that are rated by an NRSRO or classified by NASD for purposes of TRACE as BBB or lower be subject to special dissemination provisions during a brief period beginning with the day a newly issued security is priced, and ending, alternatively, after either two business days (“New Issue Aftermarket-2”) or ten business days (“New Issue Aftermarket-10”),<sup>11</sup> depending on the rating of the TRACE-eligible security.<sup>12</sup>

Transactions in newly issued TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BBB executed during their New Issue Aftermarket-2 will be subject to a dissemination delay. NASD will disseminate the withheld transaction

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<sup>9</sup> Rule 6250(a)(3).

<sup>10</sup> Rule 6250(a)(4).

<sup>11</sup> The first day of the period, New Issue Aftermarket-2 or, New Issue Aftermarket-10, is the day that the newly issued security is priced.

<sup>12</sup> Secondary market transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as A or higher are not subject to New Issue Aftermarket dissemination delays. Accordingly, NASD will disseminate all such secondary market transactions immediately upon receipt of the transaction information.

information on all transactions executed during the New Issue Aftermarket-2 starting on the next (third) business day in accordance with NASD dissemination protocols.<sup>13</sup>

Transactions in newly issued TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower executed during their New Issue Aftermarket-10 will also be subject to a dissemination delay. NASD will disseminate the withheld transaction information on all transactions executed during the New Issue Aftermarket-10 starting on the next (eleventh) business day, according to dissemination protocols established by NASD. Transaction information that is withheld pursuant to proposed Rule 6250(a)(1) and (a)(2) will be disseminated, in the order of the date and time of execution of the transactions.

Proposed Dissemination For Secondary Market Transactions Other Than New Issue Aftermarket

NASD is proposing to add new Rule 6250(b)(1) to require that the following types of transactions be disseminated immediately upon receipt: (i) transactions in any Investment Grade TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as A or higher; (ii) transactions in a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as BBB that are executed other than during its New Issue Aftermarket-2; and; (iii) transactions in a TRACE-eligible security rated by an NRSRO or

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<sup>13</sup> NASD is developing dissemination protocols for TRACE to implement dissemination provisions that require specific system enhancements. The dissemination protocols will address primarily the delayed dissemination provisions in proposed Rule 6250(b)(2) that apply to certain transactions in TRACE-eligible securities rated BB, and others rated B or lower. For example, it is currently anticipated that TRACE-eligible securities transactions that occur during the New Issue Aftermarket-2 will be disseminated prior to 8:00 a.m. Eastern Time on the next (third) business day in order of execution date and time. Market participants will be notified of the dissemination protocols prior to their implementation.

classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower that are executed other than during its New Issue Aftermarket-10, if the size of the transaction is \$1 million or less (par value), or the size is greater than \$1 million (par value), and the security is traded, on average, one or more times per day.<sup>14</sup> As noted previously, NASD estimates that approximately 99 percent of all secondary public transactions and 95 percent of par value traded in TRACE-eligible securities will be disseminated immediately upon NASD's receipt of the transaction information pursuant to these proposed dissemination protocols.

NASD is also proposing in Rule 6250(b)(2) that certain transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower (other than those executed during the subject security's New Issue Aftermarket-10) be subject to either a two-business-day or four-business-day delay before the transaction information is disseminated. Under proposed Rule 6250(b)(2)(A), NASD will disseminate transaction information two business days from the time of execution of the transaction when the transaction meets the following three criteria:<sup>15</sup> (i) the size is greater than \$1 million (par value); (ii) the TRACE-eligible security is traded, on average, less than one time per day;<sup>16</sup> and (iii) the security is rated by an NRSRO or classified by NASD for purposes of TRACE as BB. Under proposed Rule 6250(b)(2)(B), NASD will disseminate

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<sup>14</sup> Initially, NASD will determine the average over the 10-business-day New Issue Aftermarket-10. Thereafter, NASD will determine the average based on the last 20 business days of a 90-day period determined each quarter by NASD.

<sup>15</sup> For example, if a transaction meeting the three criteria is executed on Monday, September 13, 2004, at 10:00 a.m. Eastern Time, the transaction will be disseminated on Wednesday, September 15, 2004, at approximately 10:01 a.m. Eastern Time.

transaction information four business days from the time of execution<sup>17</sup> on securities rated by an NRSRO or classified by NASD for purposes of TRACE as B or lower when the transaction falls within criteria (i) and (ii) above.

For purposes of calculating the average daily trading of a security pursuant to proposed Rule 6250(b)(1)(C)(ii), Rule 6250(b)(2)(A)(ii) and Rule 6250(b)(2)(B)(ii), NASD, where applicable, will review a security's trading during its New Issue Aftermarket-10 to determine the appropriate dissemination protocol. That dissemination protocol will remain in effect for the security, until the next established calculation timeframe occurs. That calculation timeframe will be based on the trading activity during the last 20 business days of a 90-day period determined by NASD ("20/90 period"). Unlike a New Issue Aftermarket-10, where the timing is specific to the security, the 20/90 period will be established quarterly and will apply to all Non-Investment Grade TRACE-eligible securities.<sup>18</sup>

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<sup>16</sup> See note 14, *supra*.

<sup>17</sup> For example, if a transaction is executed on Monday, September 13, 2004 at 10:30 a.m. Eastern Time, the transaction will be disseminated on Friday, September 17, 2004, at approximately 10:31 a.m. Eastern Time.

<sup>18</sup> An example of the implementation of the dissemination protocols under the New Issue Aftermarket and 20/90 periods is as follows. A new issue that is rated BB (or the equivalent rating of one or more NRSROs) is priced on February 14, 2005. At the end of its New Issue Aftermarket-10, which would be March 1, 2005, NASD will determine the initial dissemination protocol of either immediate dissemination of all transactions or 2-business day delayed dissemination of transactions over \$1 million. This protocol will remain in effect until the next 20/90 period, regardless of when it is established. For example, if March 15, 2005, has been established as the end of a 90-day period, average daily trading of a security would be calculated by looking back 20 business days to February 15, 2005, and reviewing the trading that occurred in all securities during that period. The BB-rated security in this example would be subject to this 20/90-calculation period, which would include all but the first day of its New Issue Aftermarket-10. Shortly after March 15, 2005, NASD will publish the new dissemination protocols for all securities and the next 90-day period will commence on or around April 1, 2005. If a newly-issued TRACE-eligible security is priced after the first business day of the last 20 business days of the 20/90 period, the new issue dissemination protocol will apply to the security until the next 20/90 period.

Section 4(2)/Rule 144A TRACE-Eligible Securities

NASD is proposing to prohibit the dissemination of secondary market transactions effected pursuant to Rule 144A under the Securities Act of 1933. Although subject to TRACE reporting requirements, such transactions will not be subject to dissemination. This proposed change codifies the staff's position that securities that are resold pursuant to Rule 144A, although reported to TRACE for regulatory purposes, are not subject to the dissemination provisions of Rule 6250.

III. Ratings under the TRACE Rules

Current Rules

Rule 6210(h) currently defines an "Investment Grade" security as a TRACE-eligible security rated by an NRSRO "in one of its four highest generic rating categories." Rule 6210(i) currently defines "Non-Investment Grade" as a TRACE-eligible security "that is unrated, non-rated, split-rated (where one rating falls below Investment Grade), or otherwise does not meet the definition of Investment Grade as defined in Rule 6210(h)." To effectively implement the dissemination provisions in proposed Rule 6250, NASD has determined to amend the definitions of "Investment Grade" and "Non-Investment Grade," and to add a new defined term, "split-rated" in proposed Rule 6210(j).

Proposed Amendments

As noted above, TRACE rules currently classify TRACE-eligible securities as either "Investment Grade" or "Non-Investment Grade," and, in the current TRACE Rules, "split-rated" means that the ratings assigned to a TRACE-eligible security are split between those two sectors (i.e., the Investment Grade sector and the Non-Investment Grade sector) of the market, rather

than distributed among some of the nine to 12 generic rating categories used by NRSROs.<sup>19</sup> However, under current and proposed dissemination provisions, a method to categorize TRACE-eligible securities more specifically is required when, for example, a security is assigned two Non-Investment Grade ratings, but the Non-Investment ratings are not in the same generic rating category (e.g., a security is rated “Ba” by Moody’s, which is a rating in the 5<sup>th</sup> highest generic rating category, and “B” by S&P’s), which is a rating in the 6<sup>th</sup> highest generic rating category). NASD is proposing to clarify that TRACE-eligible securities, although first assigned to the universe of Investment Grade or Non-Investment Grade securities, are thereafter further classified to a specific generic rating category, using, if appropriate, the principles outlined in the new defined term, “split-rated.”

First, NASD is proposing to amend the defined terms, “Investment Grade” and “Non-Investment Grade,” in Rule 6210(h) and Rule 6210(i), respectively, to state explicitly that when a TRACE-eligible security is rated by only one NRSRO, or is rated by several NRSROs and the ratings that such NRSROs assign to the security are all in one of the four highest generic rating categories (or, conversely, all are in rating categories that are lower than the four highest such

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<sup>19</sup> The term, “generic rating category” means the rating category, however designated by symbols chosen by various NRSROs, that indicates that the bond has a grade or “quality” (e.g., the “highest quality,” the second highest quality, the third highest quality, and “medium grade” are the four Investment Grade categories, and “predominantly speculative,” “speculative, low grade” “poor to default,” “highest speculation,” “lowest quality, no interest,” which are the fifth through ninth generic rating categories, are Non-Investment Grade categories). For example, to show that a security falls within the highest generic rating category, S&P assigns a rating of “AAA” and Moody’s assigns a rating of “Aaa.” Skipping three generic rating categories, securities that are rated in the 5<sup>th</sup> highest generic rating category are rated by S&P as “BB” and by Moody’s as “Ba.” See, e.g., “Dictionary of Finance and Investment Terms (4<sup>th</sup> ed.), ed. by Downes, J., Goodman, J., 1995, pp. 458-459, for a comparison of various comparable NRSRO proprietary symbols used to rate bonds.

categories), the security will be categorized as Investment Grade (or Non-Investment Grade) in accordance with the one rating, or the multiple, similar ratings.<sup>20</sup>

If the TRACE-eligible security is rated by more than one NRSRO and not all of the ratings are in one of the four highest generic rating categories (i.e., the Investment Grade categories), NASD will classify the security as Investment Grade if a majority of such NRSROs assigned it one of the four highest generic ratings. If the NRSROs assign rating that are evenly divided between (i) the four highest generic ratings and (ii) ratings lower than the four highest generic ratings, NASD will classify the TRACE-eligible security as a Non-Investment Grade security for purposes of TRACE. As discussed in greater detail below, for purposes of TRACE, NASD also proposes to otherwise classify an unrated TRACE-eligible security as Investment Grade in certain circumstances.

Parallel provisions apply to classify TRACE-eligible securities as Non-Investment Grade securities. If rated by more than one NRSRO, and rated lower than one of the four highest generic rating categories by *all* such NRSROs, as noted above, the security will be classified for purposes of TRACE as a Non-Investment Grade security. In addition, if rated by more than one NRSRO, and rated lower than one of the four highest generic rating categories by a majority of such NRSROs, the TRACE-eligible security will be classified as a Non-Investment Grade security. Also, as discussed below, NASD is proposing that, for purposes of TRACE, NASD

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<sup>20</sup> For example, assume that three NRSROs rated XPL Security. S&P rated XPL Security as “A,” Moody’s rated it as “A,” and a third NRSRO rated it in the fourth highest generic rating category. Although the three NRSROs assigned ratings that fall in two generic rating categories, all the ratings are within the four generic rating categories that are considered “Investment Grade” ratings, so for purposes of TRACE, the security is considered “Investment Grade.”

may otherwise classify an unrated TRACE-eligible security as a Non-Investment Grade security in some circumstances.

NASD is proposing Rule 6210(j), “split-rated,” to state explicitly how NASD will classify an Investment Grade or a Non-Investment Grade TRACE-eligible security for purposes of TRACE when the security is rated by more than one NRSRO and the specific generic ratings do not fall uniformly in one generic rating category. NASD defines “split-rated” to mean “an Investment Grade or a Non-Investment Grade security that is assigned ratings by multiple NRSROs that, for an Investment Grade security, are not in the same generic Investment Grade rating category, or for a Non-Investment Grade security, are not in the same generic Non-Investment Grade rating category.” The definition then sets forth principles to apply to determine the specific generic rating for purposes of TRACE. First, after NASD determines if a security is Investment Grade or Non-Investment Grade according to the principles set forth in, respectively, Rule 6210(h) and (i), NASD then disregards any rating, for an Investment Grade security, that is Non-Investment Grade, and, for a Non-Investment Grade security, that is Investment Grade. Then, with respect to an Investment Grade security, if multiple NRSROs assign ratings that are not in the same generic Investment Grade rating category, or, with respect to a Non-Investment Grade security, if multiple NRSROs assign ratings that are not in the same generic Non-Investment Grade rating category, the following three principles apply to determine the specific rating for purposes of TRACE. First, NASD will classify the TRACE-eligible security by the generic rating that a majority or, if no majority, a plurality of such NRSROs

assigns the security.<sup>21</sup> Second, if the NRSROs assign ratings that are evenly divided between two generic rating categories, NASD will classify the security by the lower of the ratings. Third, if each of the NRSROs assigns a different rating, the TRACE-eligible security will be classified for TRACE purposes by the lower or the lowest of the ratings.<sup>22</sup>

When TRACE-eligible securities are not rated, NASD is proposing to “classify” the securities as Investment Grade or Non-Investment Grade, then more specifically in a generic rating category in order for them to be disseminated under the proposed dissemination rules, and any other provision of TRACE, if applicable. A determination is necessary because the rating (or, otherwise, the classification) of a TRACE-eligible security is a key dissemination criterion under proposed Rule 6250. NASD is amending Rule 6210(h) and Rule 6210(i) to provide for such classifications.

First, NASD may make a determination that, for the purposes of TRACE dissemination, an unrated TRACE-eligible security should be classified –i.e., considered as though having been assigned one or more ratings reflecting a specific generic rating category—when there is evidence of the issuer’s credit quality available in the bond markets. For example, NASD proposes to classify an unrated TRACE-eligible security that is newly issued if the issuer of the

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<sup>21</sup> For example, assume that four NRSROs rated XPL Security, a TRACE-eligible security. S&P rated XPL Security as “AAA,” Moody’s rated it as “Aaa,” a third NRSRO rated it in the second highest generic rating category, and a fourth NRSRO rated it in the third highest generic rating category. The ratings of the NRSROs are “split” among the three highest generic rating categories. For purposes of TRACE, NASD will treat the security as having the highest credit quality since two of the four NRSROs (a plurality) rated the security in the highest generic rating category.

<sup>22</sup> For example, assume that three NRSROs rated XPL Security. S&P rated XPL Security as “B,” Moody’s rated it as “Caa,” and a third NRSRO rated it one generic rating category lower than “Caa.” The three NRSROs have assigned ratings in three different generic rating categories, so NASD will classify the security according to the lowest generic rating category.

security has other, similar debt securities outstanding that are rated by one or more NRSROs. In such case, NASD may classify the unrated TRACE-eligible security by attributing to the security the same credit quality that is indicated by the one or more ratings assigned by the NRSROs to the issuer's rated, similar debt securities. In most cases, NASD will look to the generic rating(s) that one or more NRSROs assigned to the issuer's most recently issued and outstanding, similar debt security as the most important factor in determining the classification.<sup>23</sup> For example, if Issuer XPL has four debt securities outstanding that are rated AA and a fifth debt security comes to the market and begins trading without having received a rating, NASD may classify the TRACE-eligible security for purposes of TRACE as being in the same generic rating category as the four outstanding rated debt securities.

However, there may be instances when a TRACE-eligible security is unrated and there is not sufficient information available to NASD to make a determination, whether the security is newly issued or has been outstanding for some time. In such cases, NASD will classify the TRACE-eligible security as a "Non-Investment Grade" security that is rated B (or the equivalent rating of one or more other NRSROs) for purposes of dissemination. The basis for considering the TRACE-eligible security as a B-rated security (or the equivalent rating of one or more other NRSROs) is that the security will be disseminated according to the most conservative dissemination provisions, as a result of this administrative classification. NASD believes that this is a logical approach because such unrated securities often are considered distressed debt.

#### IV. Current Notice Provisions In Rule 6260

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<sup>23</sup> The classification of a TRACE-eligible security is an internal, administrative process of NASD. The staff will classify TRACE-eligible securities as necessary and appropriate and solely for the purpose of administering TRACE.

Rule 6260 currently requires a managing underwriter of a newly issued TRACE-eligible security to obtain and provide certain information to NASD's TRACE Operations Center. Rule 6260(b) requires the member to provide: "(1) the CUSIP number [of the new security]; (2) the issuer name; (3) the coupon rate; (4) the maturity; (5) whether Rule 144A applies; (6) a brief description of the issue; and (7) information, as determined by NASD, that is required to determine if a TRACE-eligible security must be disseminated under Rule 6250 (e.g., size of issue and rating), or if any of items (2) through (7) have not been determined, such other information as NASD deems necessary." Members must provide the information before the registration statement becomes effective, or if registration is not required, the day before the securities will be priced.<sup>24</sup> Providing the information within the time required is an essential step in effecting the timely reporting, and, if applicable, dissemination. Neither the member providing notice nor any other member engaged in secondary market trading in that security is able to report the transactions on time if the notice is not provided when required.

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<sup>24</sup> In certain intra-day offerings described in the rule, the managing underwriter may be granted additional time to provide such notice. Rule 6260(b) provides, in pertinent part:

If an issuer notifies a managing underwriter, or the issuer and the managing 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 managing underwriter shall provide the information not later than 5:00 p.m. on the day that the securities are priced and offered, provided that if such securities are priced and offered on or after 5:00 p.m., the managing underwriter shall provide the information not later than 5:00 p.m. on the next business day.

Proposed Amendments to Rule 6260

NASD is proposing to amend Rule 6260(b) to require that when NASD is notified of a new issue, the managing underwriter or a group of underwriters that is required to provide the information (e.g., CUSIP, issuer name, etc.) will also be required to provide information, as determined by NASD, to implement the New Issue Aftermarket dissemination criteria of proposed Rule 6250(a)(1) and (2). For example, NASD will require a member to provide the date and time that the new TRACE-eligible security was priced. NASD is also proposing minor technical amendments to Rule 6260.

V. Miscellaneous

With the intent of providing transaction information on a more flexible basis to better meet the changing needs of the market place, NASD is proposing to delete the provisions in Rule 6250 relating to the administration, calculation, and dissemination of “market aggregate” and “last sale” data for disseminated securities, and the treatment of TRACE-eligible securities traded after the TRACE System has closed or on a non-business day. Specifically, NASD is proposing to delete current paragraph (b) of Rule 6250, entitled, “Transactions Excluded From Market Aggregate, Last Sale,” paragraph (c) of Rule 6250, entitled, “Dissemination of Certain Trades Executed on A Business Day,” and paragraph (d) of Rule 6250, entitled, “Dissemination of Trades Executed on Non-Business Day.” NASD will establish policies for the administration, calculation and dissemination of “market aggregate” and “last sale” data that will incorporate the concepts set forth in the proposed amendments to Rule 6250 providing for both immediate and delayed dissemination of transaction information. NASD will publish information concerning

the above in various media (e.g., Notice to Members, TRACE User's Guide and the NASD website).

NASD will continue to treat transactions described in paragraphs (c) and (d) of Rule 6250 in the same manner as set forth in the Rule, provided the treatment is consistent with the proposed amendments to Rule 6250 requiring delayed dissemination and continues to meet the needs of the market place. The treatment of transactions executed after the TRACE System closes, and on weekends and holidays will be set forth in a published policy. Again, NASD will publish information concerning the above in various media (e.g., Notice to Members, TRACE User's Guide and the NASD website).

#### VI. Implementation of Proposed Dissemination Amendments

##### Staged Implementation

As noted above, NASD is proposing that the dissemination provisions be implemented in two stages because NASD must make significant operational and technical enhancements to the TRACE System, to implement certain aspects of the proposal.

Stage One. As Stage One, NASD will implement the following portions of the proposed rule change: the proposed amendments to Rule 6210 (definitions); Rule 6250(b)(1)(A) and (B), requiring immediate dissemination of all Investment Grade TRACE-eligible securities transactions, except transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BBB (or the equivalent rating of one or more NRSROs) that occur during a New Issue Aftermarket-2; under Rule 6250(b)(1)(C)(i), all TRACE-eligible securities transactions of \$1 million or less (par value) subject to dissemination, except those where the subject security does not meet the frequency standard set forth in Rule

6250(b)(1)(C)(ii);<sup>25</sup> Rule 6250(b)(1)(C)(ii), requiring immediate dissemination of all transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower that exceed \$1 million (par value) and meet the frequency test set forth in this subsection; Rule 6250(c), prohibiting the dissemination of Rule 144A transactions; and Rule 6260, providing for new issue notifications. In addition, Stage One will include the proposed deletions of current Rule 6250(a) through (d). Stage One will become effective on September 1, 2004.

Stage Two. Stage Two will consist of the implementation of proposed Rule 6250(a), providing for delayed dissemination of transaction information for transactions occurring during a New Issue Aftermarket-2 or New Issue Aftermarket-10, as defined above; the portion of proposed Rule 6250(b)(1)(C)(i) not fully implemented in Stage One;<sup>26</sup> and proposed Rule 6250(b)(2), providing for delayed dissemination of transaction information in certain transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower.

NASD is implementing these provisions as Stage Two, because the provisions cannot become effective until NASD has enhanced the TRACE System. By phasing the proposed rules in using two stages, NASD will not delay the implementation of nearly all of the dissemination provisions in Rule 6250(b)(1), which will have the greatest impact on increasing transparency. Stage Two will become effective on December 1, 2004.

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<sup>25</sup> See note 2, supra.

<sup>26</sup> Id.

Planned Review Nine Months After Stage Two Implementation

Finally, as discussed previously, NASD intends to continue to review the trading and the liquidity in TRACE-eligible securities during the implementation of Stages One and Two of the proposed rule change. As part of this review process, not later than nine months from the implementation of Stage Two, NASD will ask the BTRC to reconvene to review the rule. Based on the reviews, the BTRC and NASD staff will make recommendations to the NASD Board. The NASD Board will review the recommendations and will decide whether to amend the dissemination provisions then in effect.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the 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 believes that the proposed rule change will provide NASD with heightened capabilities to regulate and provide surveillance of the debt securities markets to prevent fraudulent and manipulative acts and practices, and will improve transparency in the debt securities markets for the benefit of customers and other market participants in furtherance of the public interest and for the protection of investors.

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

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

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 duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD, INC.

BY: \_\_\_\_\_  
Barbara Z. Sweeney, Senior Vice President and  
Corporate Secretary

Date: June 17, 2004

**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2004-094)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Proposed Amendments to TRACE Rule 6250 and Related TRACE Rules To Disseminate Transaction Information on TRACE-Eligible Securities and Facilitate Dissemination

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on , the National Association of Securities Dealers, Inc. (“NASD”), filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. 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: (1) Rule 6210 to amend two defined terms and add a new defined term; (2) Rule 6250 to expand dissemination to include all TRACE-eligible securities and to delete provisions regarding market aggregate and last sale data and the treatment of certain transaction reports; and (3) Rule 6260 to amend the notification provisions to require information needed to implement various dissemination schedules, and to make certain minor, technical changes. Rule 6210, Rule 6250 and Rule 6260 are part of the Transaction Reporting and Compliance Engine rules ("TRACE Rules"). NASD is also proposing that the amendments to Rule 6250 be implemented in two stages, and that not later than nine months after the

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

implementation of the second stage, NASD review and consider the effects of the amendments to Rule 6250 on the trading of TRACE-eligible securities, and review the dissemination provisions then in effect.

Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

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**Rule 6200. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)**

**Rule 6210. Definitions**

(a) through (g) No Change

(h) The term “Investment Grade” shall mean a TRACE-eligible security that, if rated by only one nationally recognized statistical rating organization (“NRSRO”), is rated in one of the four highest generic rating categories; or if rated by more than one NRSRO, is rated in one of the four highest generic rating categories by all or a majority of such NRSROs; provided that if the NRSROs assign ratings that are evenly divided between (i) the four highest generic ratings and (ii) ratings lower than the four highest generic ratings, NASD will classify the TRACE-eligible security as Non-Investment Grade for purposes of TRACE. If a TRACE-eligible security is unrated, for purposes of TRACE, NASD may otherwise classify the TRACE-eligible security as an Investment Grade security and further classify it as being in one of the four highest generic rating categories.[any TRACE-eligible security rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories.]

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<sup>2</sup> 17 CFR 240.19b-4.

(i) The term “Non-Investment Grade” shall mean a TRACE-eligible security that, if rated by only one NRSRO, is rated lower than one of the four highest generic rating categories; or if rated by more than one NRSRO, is rated lower than one of the four highest generic rating categories by all or a majority of such NRSROs. If a TRACE-eligible security is unrated, for purposes of TRACE, NASD may otherwise classify the TRACE-eligible security as a Non-Investment Grade security and further classify it as being in one of the generic rating categories below the four highest such categories. If NASD does not have sufficient information to make a judgment regarding the classification of an unrated TRACE-eligible security, for purposes of TRACE, NASD will classify the TRACE-eligible security as having been rated B (or the equivalent rating of one or more NRSROs).<sup>3</sup>[any TRACE-eligible security that is unrated, non-rated, split-rated (where one rating falls below Investment Grade), or otherwise does not meet the definition of Investment Grade in paragraph (h) above.]

(j) The term, “split-rated,” shall mean an Investment Grade or a Non-Investment Grade security that is assigned ratings by multiple NRSROs that, for an Investment Grade security, are not in the same generic Investment Grade rating category, or, for a Non-Investment Grade security, are not in the same generic Non-Investment Grade rating category. After determining if a security is Investment Grade or Non-Investment Grade, NASD will disregard any rating, if the security is Investment Grade, that is Non-Investment Grade, or, if the security is Non-Investment Grade, that is Investment Grade. With respect to an Investment Grade security, if multiple NRSROs assign ratings that are not in the same generic Investment Grade rating category, or,

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<sup>3</sup> “B” is a rating of Standard & Poor's, a division of the McGraw-Hill Companies, Inc. ("S&P"). S&P is a nationally recognized statistical rating organization. S&P's ratings are proprietary to S&P and are protected by copyright and other intellectual property laws. S&P's licenses ratings to NASD. Ratings may not be copied or otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed or resold, or stored

with respect to a Non-Investment Grade security, if multiple NRSROs assign ratings that are not in the same generic Non-Investment Grade rating category, NASD will classify the TRACE-eligible security for purposes of TRACE by the generic rating that a majority or, if no majority, a plurality of the NRSROs assigns the security, provided that (i) if the NRSROs assign ratings that are evenly divided between two generic rating categories, NASD will classify the TRACE-eligible security for purposes of TRACE by the lower of the ratings; or (ii) if each NRSRO assigns a different generic rating, NASD will classify the TRACE-eligible security for purposes of TRACE by the lower or lowest of the ratings.

\* \* \* \* \*

#### **6250. Dissemination of [Corporate Bond Trade]Transaction Information**

##### **(a) Dissemination of New Issue Aftermarket Transactions**

(1) Transaction information for TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BBB (or the equivalent rating of one or more NRSROs) executed during the period beginning the day a newly issued security is priced and lasting two business days (“New Issue Aftermarket-2”) will not be disseminated during the New Issue Aftermarket-2. NASD will disseminate transaction information for transactions executed during the New Issue Aftermarket-2 starting on the next (third) business day, according to dissemination protocols established by NASD.

(2) Transaction information for TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower executed during the period beginning the day a newly

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for subsequent use for any such purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person without S&P's prior written consent.

issued security is priced and lasting 10 business days (“New Issue Aftermarket-10”) will not be disseminated during the New Issue Aftermarket-10. NASD will disseminate transaction information for transactions executed during the New Issue Aftermarket-10 starting on the next (eleventh) business day, according to dissemination protocols established by NASD.

**(b) Dissemination of Secondary Market Transactions**

(1) Immediate Dissemination. NASD will disseminate transaction information immediately upon receipt of a transaction report, if the report is for a transaction:

(A) In a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE above BBB (or the equivalent rating of one or more NRSROs); or

(B) In a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as BBB (or the equivalent rating of one or more NRSROs) executed other than during the New Issue Aftermarket-2; or,

(C) In a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower executed other than during the New Issue Aftermarket-10 if:

(i) the size of the transaction is \$1 million or less (par value);

or

(ii) the size of the transaction is greater than \$1 million (par value), and the TRACE-eligible security is traded (a) an average of one or

more times per day, during the New Issue Aftermarket-10; and (b) thereafter, an average of one or more times per day over the last 20 business days of a 90-day period determined each quarter by NASD. Such security shall remain subject to immediate dissemination until such 90-day period in which the security fails to meet the condition set forth in this subparagraph (C)(ii)(b), in which case it shall be subject to a two-or four-business day delayed dissemination, as applicable.

(2) Two- or Four-Business-Day Delayed Dissemination. For transactions in a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower executed other than during the New Issue Aftermarket-10, NASD will disseminate transaction information on a two- or four-business-day delayed basis from the time of execution as follows:

(A) Two-Business-Day Delay. In a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) if:

(i) the size of the transaction is greater than \$1 million (par value); and

(ii) the security is traded (a) an average of less than one time per day, during the New Issue Aftermarket-10; and (b) thereafter, an average of less than one time per day over the last 20 business days of a 90-day period determined each quarter by NASD. Such security shall remain subject to a two-business day delayed dissemination until such 90-

day period in which the security fails to meet the condition set forth in this subparagraph (A)(ii)(b), in which case it shall be subject to immediate dissemination.

(B) Four-Business-Day Delay. In a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as B (or the equivalent rating of one or more NRSROs) or lower if:

(i) the size of the transaction is greater than \$1 million (par value) and;

(ii) the security is traded (a) an average of less than one time per day, during the New Issue Aftermarket-10; and (b) thereafter, an average of less than one time per day over the last 20 business days of a 90-day period determined each quarter by NASD. Such security shall remain subject to a four-business day delayed dissemination until such 90-day period in which the security fails to meet the condition set forth in this subparagraph (B)(ii)(b), in which case it shall be subject to immediate dissemination.

**(c) Rule 144A**

NASD will not disseminate information on a transaction in a TRACE-eligible security that is issued pursuant to Section 4(2) of the Securities Act of 1933 and resold pursuant to Rule 144A under the Securities Act of 1933.

**[(a) General Dissemination Standard]**

Immediately upon receipt of transaction reports received at or after 8:00 a.m. through 6:29:59 p.m. Eastern Time, NASD will disseminate transaction information (except that market aggregate information and last sale information will not be updated after 5:15 p.m. Eastern Time) in the securities described below.

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

(2) A TRACE-eligible security that is Non-Investment Grade at the time of receipt of the transaction report and is designated by NASD for dissemination according to the following criteria.

(A) The staff of NASD will designate fifty of the most actively traded Non-Investment Grade securities that are TRACE-eligible securities for dissemination under this rule, based on (i) the security's volume; (ii) the security's price; (iii) the security's name recognition; (iv) the research following of the security; (v) the security having a minimum number of bonds outstanding; (vi) the security being traded routinely by at least two dealers; and (vii) the security contributing to a representation of diverse industry groups in the group of securities designated for dissemination.

(B) A Non-Investment Grade security will not be designated, and may be immediately withdrawn from designation, for dissemination under this rule if the security: (i) has matured; (ii) has been called; (iii) has been upgraded to Investment Grade; or (iv) has been downgraded to an extent that the security's trading characteristics do not warrant designation for dissemination.

(3) A TRACE-eligible security that is Investment Grade, is rated by Moody's Investors

Service, Inc. as "A3"<sup>1</sup> or higher, and by Standard & Poor's, a division of McGraw Hill Co., Inc., as "A-"<sup>2</sup> or higher, and has an original issue size of \$100 million or greater. If a security is rated under this provision to qualify for dissemination at any time on or after the effective date of the rule, dissemination of transaction information on the security will continue under this paragraph unless the security is downgraded below Baa3/BBB-.

[<sup>1</sup> Moody's Investors Service, Inc. ("Moody's") is a nationally recognized statistical rating organization. Moody's is a registered trademark of Moody's Investors Service. Moody's ratings are proprietary to Moody's and are protected by copyright and other intellectual property laws. Moody's licenses ratings to NASD. Ratings may not be copied or otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed or resold, or stored for subsequent use for any purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person without Moody's prior written consent.]

[<sup>2</sup> Standard & Poor's, a division of the McGraw-Hill Companies, Inc. ("S&P"), is a nationally recognized statistical rating organization. S&P's ratings are proprietary to S&P and are protected by copyright and other intellectual property laws. S&P's licenses ratings to NASD. Ratings may not be copied or otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed or resold, or stored for subsequent use for any such purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person without S&P's prior written consent.]

(4) Ninety to 120 TRACE-eligible securities designated by NASD that are rated "Baa/BBB" at the time of designation, according to the following standards.

(A) Three groups, each composed of up to 50 TRACE-eligible securities (Group 1, Group 2, and Group 3), but collectively not exceeding 120, shall be designated by NASD. At the time of designation, each TRACE-eligible security in Group 1 must be rated "Baa1/BBB+" and each TRACE-eligible security in Group 2 and Group 3, must be rated, respectively, "Baa2/BBB" and "Baa3/BBB-." If a TRACE-eligible security is rated one of the "Baa" ratings by Moody's and one of the "BBB" ratings by S&P and the ratings indicate two different levels of credit quality, the lower of the two ratings will be used to determine the group to which a debt security will be assigned under this paragraph (a)(4).

(B) A TRACE-eligible security that has a rating from only one rating agency will not be designated under paragraph (a)(4).

(C) Dissemination of transaction information on a TRACE-eligible security that is designated under paragraph (a)(4) will not be discontinued if one rating is, or both ratings, are downgraded or upgraded.]

**[(b) Transactions Excluded From Market Aggregate, Last Sale**

All trade reports in TRACE-eligible securities that are approved for dissemination and submitted to TRACE at or after 8:00 a.m. Eastern Time and 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;

- (4) trades in which the price is determined by a weighted average price; and
- (5) trades in which the price is a "special price," as indicated by the use of the special price modifier.]

**[(c) Dissemination of Certain Trades Executed on A Business Day**

(1) Reports of transactions in TRACE-eligible securities that are subject to dissemination, are executed on a business day at or after 6:30 p.m. Eastern Time through 11:59:59 p.m. Eastern Time, and are reported pursuant to Rule 6230(a)(2) on the next business day and designated "as/of" will be disseminated beginning at 8:00 a.m. Eastern Time on the day of receipt. The reported information will not be included in the calculation of the day's market aggregates.

(2) Reports of transactions in TRACE-eligible securities that are subject to dissemination, are executed on a business day at or after 12:00 a.m. Eastern Time through 7:59:59 a.m. Eastern Time, and are reported pursuant to Rule 6230(a)(3) on the same day beginning at 8:00 a.m. Eastern Time will be disseminated upon receipt. The reported information will be included in the calculation of the day's market aggregates, except as otherwise provided in Rule 6250(b)(1) through (5).]

**[(d) Dissemination of Trades Executed on Non-Business Days**

Reports of transactions in TRACE-eligible securities that are subject to dissemination, are executed on a non-business day at any time during the day, and are reported pursuant to Rule 6230(a)(4) on the next business day will be disseminated upon receipt. The reported information will not be included in the calculation of the day's market aggregates.]

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**Rule 6260. Managing Underwriter or Group of Underwriters Obligation To Obtain CUSIP and Provide Notice**

**(a) Members Required to Provide Information and Notice**

(1) In order to facilitate trade reporting and dissemination of secondary transactions in TRACE-eligible securities, the member that is the managing underwriter or the members that are the group of underwriters of a distribution or offering, excluding a secondary distribution or offering, of a debt security that, upon issuance will be a TRACE-eligible security (“new issue”),[of any newly issued TRACE-eligible security] must obtain and provide information [by email or facsimile]to the TRACE Operations Center as required below.[under paragraph (b).] If a managing underwriter is not appointed, the group of underwriters must provide the information required under this rule.[comply with paragraph (b).]

(2) The information must be provided by facsimile or e-mail.

**(b) Notices**

For such [TRACE-eligible securities]new issues, the managing underwriter or group of underwriters must provide to the TRACE Operations Center[, by email or facsimile]: (1) the CUSIP number; (2) the issuer name; (3) the coupon rate; (4) the maturity; (5) whether Rule 144A applies; (6) a brief description of the issue (e.g., senior subordinated note, senior note); and, (7) information, as determined by NASD, [that is required to determine ]to implement the provisions of Rule 6250(a) and such other information NASD deems necessary to properly implement the reporting and dissemination of a TRACE-eligible security[if a TRACE-eligible security must be disseminated under Rule 6250 (e.g., size of issue and rating)], or if any of items (2)

through (7) has not been determined, such other information as NASD deems necessary. The managing underwriter or group of underwriters must obtain the CUSIP number and provide it and the information listed as (2) through (7) not later than 5:00 p.m. Eastern Time 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 a managing underwriter or group of underwriters, or the issuer and the managing underwriter or group of underwriters 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 Section 4(2) and Rule 144A of the Securities Act of 1933, the managing underwriter or group of underwriters shall provide the information not later than 5:00 p.m. Eastern Time on the day that the securities are priced and offered, provided that if such securities are priced and offered on or after 5:00 p.m. Eastern Time, the managing underwriter or group of underwriters shall provide the information not later than 5:00 p.m. Eastern Time on the next business day. The managing underwriter or group of underwriters must make a good faith determination that the security is a TRACE-eligible security before submitting the information to the TRACE Operations Center.

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II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV

below. NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

I. Introduction and Background

In this proposed rule change, NASD is proposing to amend Rule 6250 to disseminate publicly transaction information for secondary market transactions in all TRACE-eligible securities, and to make related amendments to Rule 6210 and Rule 6260 to facilitate dissemination. The proposed amendments will result in NASD disseminating all TRACE-eligible securities transactions, except transactions executed pursuant to Rule 144A under the Securities Act of 1933.<sup>2</sup> Implementation of the proposed rule change is estimated to result in immediate dissemination of approximately 99 percent of all transactions in TRACE-eligible securities and 95 percent of the par value traded in such securities. Information on certain transactions, however, will be disseminated on a delayed basis. NASD is also proposing to delete provisions regarding market aggregates, last sale data, and the treatment of certain transaction reports in Rule 6250.

NASD is also proposing amendments to Rule 6210 and Rule 6260. In Rule 6210, NASD is proposing to amend the definitions of “Investment Grade” and “Non-Investment Grade” and to add a new defined term, “split-rated.” In Rule 6260, NASD is proposing to amend the

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<sup>4</sup> Under Rule 6230(e), certain types of transactions currently are exempt from reporting (and therefore dissemination) (e.g., qualifying transactions in TRACE-eligible securities that are listed on a national securities exchange, when such transactions are executed on and reported to the exchange and the transaction information is disseminated publicly, and a parallel exemption for qualifying transactions in TRACE-eligible securities that are listed on The Nasdaq Stock Market, Inc.), and will continue to be exempt from reporting (and dissemination) under the proposal.

notification requirements, which will aid NASD in identifying new issues of TRACE-eligible securities and the dissemination protocols that apply to them.

NASD is also proposing that the proposed amendments to Rule 6250 regarding dissemination be implemented in two stages, Stage One and Stage Two, because certain aspects of the proposal providing for delayed dissemination will require significant operational and technical changes to NASD's TRACE System. Finally, not later than nine months after the implementation of Stage Two, NASD will review and consider the effects of the amendments to Rule 6250 on the trading of TRACE-eligible securities, and review the dissemination provisions then in effect.

The dissemination proposal was developed in consultation with the Bond Transaction Reporting Committee ("BTRC"), an advisory committee to the NASD Board of Governors.<sup>5</sup> The primary role of the BTRC is to make recommendations to the NASD Board concerning the dissemination of transaction information under TRACE for secondary market transactions in eligible corporate bonds. To develop this proposal, the BTRC and NASD staff analyzed significant amounts of TRACE transaction data and deliberated on various dissemination approaches.

Initial concerns of certain market participants focused on the possible impact that increased transparency may have on market liquidity. After extensive examination of approximately 18 months of TRACE data and review of two studies performed by an outside econometric team, NASD found no conclusive evidence that TRACE transparency has adversely

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<sup>5</sup> The Committee is appointed by the NASD Board of Governors and has ten members. Five of the members were recommended by the staff of NASD and the other five were recommended by The Bond Market Association ("TBMA").

affected liquidity. Accordingly, NASD believes full transparency is warranted. As noted above, the proposed rule change will result in dissemination of all public secondary market transactions in TRACE-eligible securities, with approximately 99 percent of total transactions and 95 percent of total par value traded being immediately disseminated.

However, there are two areas of possible concern where NASD currently believes that a more measured approach toward immediate dissemination is in the best interest of investors and the corporate bond market. First, both institutional investors and dealers have expressed concern that liquidity could be harmed by the immediate transparency of large transactions in Non-Investment Grade securities, and particularly in such securities that trade infrequently. Second, similar liquidity concerns were raised regarding the few transactions that are effected in the New Issue Aftermarket-2 or -10 for securities rated BBB or lower,<sup>6</sup> where reduced liquidity could potentially increase borrowing cost to issuers. Although there was no conclusive proof of harm to the market in these two areas, NASD believes that the measured approach reflected by the dissemination delays set forth in the proposed rule change will provide additional time to assess the impact of transparency on this small number of transactions.

NASD intends to continue to review the trading and the liquidity in TRACE-eligible securities during the implementation of Stages One and Two of the proposed rule change. As part of this review process, not later than nine months from the implementation of Stage Two,

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<sup>6</sup> For purposes of this filing, “BBB,” a rating of Standard & Poors (“S&P”) or any other rating of S&P means the S&P rating and the equivalent ratings of Moody’s Investors Service, Inc. (“Moody’s”) and any other NRSRO whose rating may be used for purposes of TRACE. Currently, NASD administers the TRACE dissemination provisions based on the ratings of S&P’s and Moody’s. The use of a single rating in this rule filing is for the convenience of readers only.

NASD will ask the BTRC to reconvene to review the rule and make recommendations to the NASD Board of Governors.

## II. The Dissemination Proposal

### Current Dissemination Requirements

In current Rule 6250, NASD requires the dissemination of transaction information for four categories of securities: (1) a TRACE-eligible security that is Investment Grade at the time of receipt of the transaction report and has an initial issuance size of \$1 billion or greater;<sup>7</sup> (2) approximately 50 Non-Investment Grade TRACE-eligible securities that are designated by NASD staff according to the criteria, including liquidity, set forth in Rule 6250(a)(2);<sup>8</sup> (3) any TRACE-eligible security that is Investment Grade, rated A or higher and has an original issue size of \$100 million or greater, unless downgraded below BBB;<sup>9</sup> and (4) approximately 120 TRACE-eligible securities rated BBB at the time they were designated for dissemination.<sup>10</sup> All current dissemination is “immediate”; NASD disseminates the transaction information as soon as it is reported to NASD.

### Proposed Dissemination for Transactions During the New Issue Aftermarket

NASD is proposing that dissemination for TRACE-eligible securities that are rated by an NRSRO or classified by NASD for purposes of TRACE as BBB or lower be subject to special dissemination provisions during a brief period beginning with the day a newly issued security is

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<sup>7</sup> Rule 6250(a)(1).

<sup>8</sup> From time to time, the staff reviews and amends the list of 50 securities; in between such comprehensive reviews, securities may be called or the staff may delete certain securities that no longer meet the criteria, at times resulting in the dissemination of less than 50 securities. See Rule 6250(a)(2).

<sup>9</sup> Rule 6250(a)(3).

<sup>10</sup> Rule 6250(a)(4).

priced, and ending, alternatively, after either two business days (“New Issue Aftermarket-2”) or ten business days (“New Issue Aftermarket-10”),<sup>11</sup> depending on the rating of the TRACE-eligible security.<sup>12</sup>

Transactions in newly issued TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BBB executed during their New Issue Aftermarket-2 will be subject to a dissemination delay. NASD will disseminate the withheld transaction information on all transactions executed during the New Issue Aftermarket-2 starting on the next (third) business day in accordance with NASD dissemination protocols.<sup>13</sup>

Transactions in newly issued TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower executed during their New Issue Aftermarket-10 will also be subject to a dissemination delay. NASD will disseminate the withheld transaction information on all transactions executed during the New Issue Aftermarket-10 starting on the next (eleventh) business day, according to dissemination protocols established by NASD. Transaction information that is withheld pursuant to proposed Rule 6250(a)(1) and (a)(2) will be disseminated, in the order of the date and time of execution of the transactions.

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<sup>11</sup> The first day of the period, New Issue Aftermarket-2 or, New Issue Aftermarket-10, is the day that the newly issued security is priced.

<sup>12</sup> Secondary market transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as A or higher are not subject to New Issue Aftermarket dissemination delays. Accordingly, NASD will disseminate all such secondary market transactions immediately upon receipt of the transaction information.

<sup>13</sup> NASD is developing dissemination protocols for TRACE to implement dissemination provisions that require specific system enhancements. The dissemination protocols will address primarily the delayed dissemination provisions in proposed Rule 6250(b)(2) that apply to certain transactions in TRACE-eligible securities rated BB, and others rated B or lower. For example, it is currently anticipated that TRACE-eligible securities transactions that occur during the New Issue Aftermarket-2 will be disseminated prior to 8:00 a.m.

Proposed Dissemination For Secondary Market Transactions Other Than New Issue Aftermarket

NASD is proposing to add new Rule 6250(b)(1) to require that the following types of transactions be disseminated immediately upon receipt: (i) transactions in any Investment Grade TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as A or higher; (ii) transactions in a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as BBB that are executed other than during its New Issue Aftermarket-2; and; (iii) transactions in a TRACE-eligible security rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower that are executed other than during its New Issue Aftermarket-10, if the size of the transaction is \$1 million or less (par value), or the size is greater than \$1 million (par value), and the security is traded, on average, one or more times per day.<sup>14</sup> As noted previously, NASD estimates that approximately 99 percent of all secondary public transactions and 95 percent of par value traded in TRACE-eligible securities will be disseminated immediately upon NASD's receipt of the transaction information pursuant to these proposed dissemination protocols.

NASD is also proposing in Rule 6250(b)(2) that certain transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower (other than those executed during the subject security's New Issue Aftermarket-10) be subject to either a two-business-day or four-

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Eastern Time on the next (third) business day in order of execution date and time. Market participants will be notified of the dissemination protocols prior to their implementation.

<sup>14</sup> Initially, NASD will determine the average over the 10-business-day New Issue Aftermarket-10. Thereafter, NASD will determine the average based on the last 20 business days of a 90-day period determined each quarter by NASD.

business-day delay before the transaction information is disseminated. Under proposed Rule 6250(b)(2)(A), NASD will disseminate transaction information two business days from the time of execution of the transaction when the transaction meets the following three criteria:<sup>15</sup> (i) the size is greater than \$1 million (par value); (ii) the TRACE-eligible security is traded, on average, less than one time per day;<sup>16</sup> and (iii) the security is rated by an NRSRO or classified by NASD for purposes of TRACE as BB. Under proposed Rule 6250(b)(2)(B), NASD will disseminate transaction information four business days from the time of execution<sup>17</sup> on securities rated by an NRSRO or classified by NASD for purposes of TRACE as B or lower when the transaction falls within criteria (i) and (ii) above.

For purposes of calculating the average daily trading of a security pursuant to proposed Rule 6250(b)(1)(C)(ii), Rule 6250(b)(2)(A)(ii) and Rule 6250(b)(2)(B)(ii), NASD, where applicable, will review a security's trading during its New Issue Aftermarket-10 to determine the appropriate dissemination protocol. That dissemination protocol will remain in effect for the security, until the next established calculation timeframe occurs. That calculation timeframe will be based on the trading activity during the last 20 business days of a 90-day period determined by NASD ("20/90 period"). Unlike a New Issue Aftermarket-10, where the timing is specific to

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<sup>15</sup> For example, if a transaction meeting the three criteria is executed on Monday, September 13, 2004, at 10:00 a.m. Eastern Time, the transaction will be disseminated on Wednesday, September 15, 2004, at approximately 10:01 a.m. Eastern Time.

<sup>16</sup> See note 14, *supra*.

<sup>17</sup> For example, if a transaction is executed on Monday, September 13, 2004 at 10:30 a.m. Eastern Time, the transaction will be disseminated on Friday, September 17, 2004, at approximately 10:31 a.m. Eastern Time.

the security, the 20/90 period will be established quarterly and will apply to all Non-Investment Grade TRACE-eligible securities.<sup>18</sup>

#### Section 4(2)/Rule 144A TRACE-Eligible Securities

NASD is proposing to prohibit the dissemination of secondary market transactions effected pursuant to Rule 144A under the Securities Act of 1933. Although subject to TRACE reporting requirements, such transactions will not be subject to dissemination. This proposed change codifies the staff's position that securities that are resold pursuant to Rule 144A, although reported to TRACE for regulatory purposes, are not subject to the dissemination provisions of Rule 6250.

### III. Ratings under the TRACE Rules

#### Current Rules

Rule 6210(h) currently defines an "Investment Grade" security as a TRACE-eligible security rated by an NRSRO "in one of its four highest generic rating categories." Rule 6210(i) currently defines "Non-Investment Grade" as a TRACE-eligible security "that is unrated, non-rated, split-rated (where one rating falls below Investment Grade), or otherwise does not meet the definition of Investment Grade as defined in Rule 6210(h)." To effectively implement the dissemination provisions in proposed Rule 6250, NASD has determined to amend the definitions

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<sup>18</sup> An example of the implementation of the dissemination protocols under the New Issue Aftermarket and 20/90 periods is as follows. A new issue that is rated BB (or the equivalent rating of one or more NRSROs) is priced on February 14, 2005. At the end of its New Issue Aftermarket-10, which would be March 1, 2005, NASD will determine the initial dissemination protocol of either immediate dissemination of all transactions or 2-business day delayed dissemination of transactions over \$1 million. This protocol will remain in effect until the next 20/90 period, regardless of when it is established. For example, if March 15, 2005, has been established as the end of a 90-day period, average daily trading of a security would be calculated by looking back 20 business days to February 15, 2005, and reviewing the trading that occurred in all securities during that period. The BB-rated security in this example would be subject to this 20/90-calculation period, which would include all but the first day of its New Issue Aftermarket-10. Shortly after March 15, 2005, NASD will publish the new dissemination protocols for all securities and the next 90-day period will commence on or around April 1, 2005. If a newly-issued TRACE-eligible

of “Investment Grade” and “Non-Investment Grade,” and to add a new defined term, “split-rated” in proposed Rule 6210(j).

#### Proposed Amendments

As noted above, TRACE rules currently classify TRACE-eligible securities as either “Investment Grade” or “Non-Investment Grade,” and, in the current TRACE Rules, “split-rated” means that the ratings assigned to a TRACE-eligible security are split between those two sectors (i.e., the Investment Grade sector and the Non-Investment Grade sector) of the market, rather than distributed among some of the nine to 12 generic rating categories used by NRSROs.<sup>19</sup> However, under current and proposed dissemination provisions, a method to categorize TRACE-eligible securities more specifically is required when, for example, a security is assigned two Non-Investment Grade ratings, but the Non-Investment ratings are not in the same generic rating category (e.g., a security is rated “Ba” by Moody’s, which is a rating in the 5<sup>th</sup> highest generic rating category, and “B” by S&P’s), which is a rating in the 6<sup>th</sup> highest generic rating category). NASD is proposing to clarify that TRACE-eligible securities, although first assigned to the universe of Investment Grade or Non-Investment Grade securities, are thereafter further

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security is priced after the first business day of the last 20 business days of the 20/90 period, the new issue dissemination protocol will apply to the security until the next 20/90 period.

<sup>19</sup> The term, “generic rating category” means the rating category, however designated by symbols chosen by various NRSROs, that indicates that the bond has a grade or “quality” (e.g., the “highest quality,” the second highest quality, the third highest quality, and “medium grade” are the four Investment Grade categories, and “predominantly speculative,” “speculative, low grade” “poor to default,” “highest speculation,” “lowest quality, no interest,” which are the fifth through ninth generic rating categories, are Non-Investment Grade categories). For example, to show that a security falls within the highest generic rating category, S&P assigns a rating of “AAA” and Moody’s assigns a rating of “Aaa.” Skipping three generic rating categories, securities that are rated in the 5<sup>th</sup> highest generic rating category are rated by S&P as “BB” and by Moody’s as “Ba.” See, e.g., “Dictionary of Finance and Investment Terms (4<sup>th</sup> ed.), ed. by Downes, J., Goodman, J., 1995, pp. 458-459, for a comparison of various comparable NRSRO proprietary symbols used to rate bonds.

classified to a specific generic rating category, using, if appropriate, the principles outlined in the new defined term, “split-rated.”

First, NASD is proposing to amend the defined terms, “Investment Grade” and “Non-Investment Grade,” in Rule 6210(h) and Rule 6210(i), respectively, to state explicitly that when a TRACE-eligible security is rated by only one NRSRO, or is rated by several NRSROs and the ratings that such NRSROs assign to the security are all in one of the four highest generic rating categories (or, conversely, all are in rating categories that are lower than the four highest such categories), the security will be categorized as Investment Grade (or Non-Investment Grade) in accordance with the one rating, or the multiple, similar ratings.<sup>20</sup>

If the TRACE-eligible security is rated by more than one NRSRO and not all of the ratings are in one of the four highest generic rating categories (i.e., the Investment Grade categories), NASD will classify the security as Investment Grade if a majority of such NRSROs assigned it one of the four highest generic ratings. If the NRSROs assign rating that are evenly divided between (i) the four highest generic ratings and (ii) ratings lower than the four highest generic ratings, NASD will classify the TRACE-eligible security as a Non-Investment Grade security for purposes of TRACE. As discussed in greater detail below, for purposes of TRACE, NASD also proposes to otherwise classify an unrated TRACE-eligible security as Investment Grade in certain circumstances.

Parallel provisions apply to classify TRACE-eligible securities as Non-Investment Grade securities. If rated by more than one NRSRO, and rated lower than one of the four highest

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<sup>20</sup> For example, assume that three NRSROs rated XPL Security. S&P rated XPL Security as “A,” Moody’s rated it as “A,” and a third NRSRO rated it in the fourth highest generic rating category. Although the three NRSROs assigned ratings that fall in two generic rating categories, all the ratings are within the four generic rating

generic rating categories by *all* such NRSROs, as noted above, the security will be classified for purposes of TRACE as a Non-Investment Grade security. In addition, if rated by more than one NRSRO, and rated lower than one of the four highest generic rating categories by a majority of such NRSROs, the TRACE-eligible security will be classified as a Non-Investment Grade security. Also, as discussed below, NASD is proposing that, for purposes of TRACE, NASD may otherwise classify an unrated TRACE-eligible security as a Non-Investment Grade security in some circumstances.

NASD is proposing Rule 6210(j), “split-rated,” to state explicitly how NASD will classify an Investment Grade or a Non-Investment Grade TRACE-eligible security for purposes of TRACE when the security is rated by more than one NRSRO and the specific generic ratings do not fall uniformly in one generic rating category. NASD defines “split-rated” to mean “an Investment Grade or a Non-Investment Grade security that is assigned ratings by multiple NRSROs that, for an Investment Grade security, are not in the same generic Investment Grade rating category, or for a Non-Investment Grade security, are not in the same generic Non-Investment Grade rating category.” The definition then sets forth principles to apply to determine the specific generic rating for purposes of TRACE. First, after NASD determines if a security is Investment Grade or Non-Investment Grade according to the principles set forth in, respectively, Rule 6210(h) and (i), NASD then disregards any rating, for an Investment Grade security, that is Non-Investment Grade, and, for a Non-Investment Grade security, that is Investment Grade. Then, with respect to an Investment Grade security, if multiple NRSROs assign ratings that are not in the same generic Investment Grade rating category, or, with respect

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categories that are considered “Investment Grade” ratings, so for purposes of TRACE, the security is considered “Investment Grade.”

to a Non-Investment Grade security, if multiple NRSROs assign ratings that are not in the same generic Non-Investment Grade rating category, the following three principles apply to determine the specific rating for purposes of TRACE. First, NASD will classify the TRACE-eligible security by the generic rating that a majority or, if no majority, a plurality of such NRSROs assigns the security.<sup>21</sup> Second, if the NRSROs assign ratings that are evenly divided between two generic rating categories, NASD will classify the security by the lower of the ratings. Third, if each of the NRSROs assigns a different rating, the TRACE-eligible security will be classified for TRACE purposes by the lower or the lowest of the ratings.<sup>22</sup>

When TRACE-eligible securities are not rated, NASD is proposing to “classify” the securities as Investment Grade or Non-Investment Grade, then more specifically in a generic rating category in order for them to be disseminated under the proposed dissemination rules, and any other provision of TRACE, if applicable. A determination is necessary because the rating (or, otherwise, the classification) of a TRACE-eligible security is a key dissemination criterion under proposed Rule 6250. NASD is amending Rule 6210(h) and Rule 6210(i) to provide for such classifications.

First, NASD may make a determination that, for the purposes of TRACE dissemination, an unrated TRACE-eligible security should be classified –i.e., considered as though having been

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<sup>21</sup> For example, assume that four NRSROs rated XPL Security, a TRACE-eligible security. S&P rated XPL Security as “AAA,” Moody’s rated it as “Aaa,” a third NRSRO rated it in the second highest generic rating category, and a fourth NRSRO rated it in the third highest generic rating category. The ratings of the NRSROs are “split” among the three highest generic rating categories. For purposes of TRACE, NASD will treat the security as having the highest credit quality since two of the four NRSROs (a plurality) rated the security in the highest generic rating category.

<sup>22</sup> For example, assume that three NRSROs rated XPL Security. S&P rated XPL Security as “B,” Moody’s rated it as “Caa,” and a third NRSRO rated it one generic rating category lower than “Caa.” The three NRSROs

assigned one or more ratings reflecting a specific generic rating category—when there is evidence of the issuer’s credit quality available in the bond markets. For example, NASD proposes to classify an unrated TRACE-eligible security that is newly issued if the issuer of the security has other, similar debt securities outstanding that are rated by one or more NRSROs. In such case, NASD may classify the unrated TRACE-eligible security by attributing to the security the same credit quality that is indicated by the one or more ratings assigned by the NRSROs to the issuer’s rated, similar debt securities. In most cases, NASD will look to the generic rating(s) that one or more NRSROs assigned to the issuer’s most recently issued and outstanding, similar debt security as the most important factor in determining the classification.<sup>23</sup> For example, if Issuer XPL has four debt securities outstanding that are rated AA and a fifth debt security comes to the market and begins trading without having received a rating, NASD may classify the TRACE-eligible security for purposes of TRACE as being in the same generic rating category as the four outstanding rated debt securities.

However, there may be instances when a TRACE-eligible security is unrated and there is not sufficient information available to NASD to make a determination, whether the security is newly issued or has been outstanding for some time. In such cases, NASD will classify the TRACE-eligible security as a “Non-Investment Grade” security that is rated B (or the equivalent rating of one or more other NRSROs) for purposes of dissemination. The basis for considering the TRACE-eligible security as a B-rated security (or the equivalent rating of one or more other NRSROs) is that the security will be disseminated according to the most conservative

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have assigned ratings in three different generic rating categories, so NASD will classify the security according to the lowest generic rating category.

dissemination provisions, as a result of this administrative classification. NASD believes that this is a logical approach because such unrated securities often are considered distressed debt.

#### IV. Current Notice Provisions In Rule 6260

Rule 6260 currently requires a managing underwriter of a newly issued TRACE-eligible security to obtain and provide certain information to NASD's TRACE Operations Center. Rule 6260(b) requires the member to provide: "(1) the CUSIP number [of the new security]; (2) the issuer name; (3) the coupon rate; (4) the maturity; (5) whether Rule 144A applies; (6) a brief description of the issue; and (7) information, as determined by NASD, that is required to determine if a TRACE-eligible security must be disseminated under Rule 6250 (e.g., size of issue and rating), or if any of items (2) through (7) have not been determined, such other information as NASD deems necessary." Members must provide the information before the registration statement becomes effective, or if registration is not required, the day before the securities will be priced.<sup>24</sup> Providing the information within the time required is an essential step in effecting the timely reporting, and, if applicable, dissemination. Neither the member providing notice nor any other member engaged in secondary market trading in that security is able to report the transactions on time if the notice is not provided when required.

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<sup>23</sup> The classification of a TRACE-eligible security is an internal, administrative process of NASD. The staff will classify TRACE-eligible securities as necessary and appropriate and solely for the purpose of administering TRACE.

<sup>24</sup> In certain intra-day offerings described in the rule, the managing underwriter may be granted additional time to provide such notice. Rule 6260(b) provides, in pertinent part:

If an issuer notifies a managing underwriter, or the issuer and the managing 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 managing underwriter shall provide the information not later than 5:00 p.m. on the day that the securities are priced and offered, provided that if such securities are priced and offered on or after 5:00 p.m., the managing underwriter shall provide the information not later than 5:00 p.m. on the next business day.

Proposed Amendments to Rule 6260

NASD is proposing to amend Rule 6260(b) to require that when NASD is notified of a new issue, the managing underwriter or a group of underwriters that is required to provide the information (e.g., CUSIP, issuer name, etc.) will also be required to provide information, as determined by NASD, to implement the New Issue Aftermarket dissemination criteria of proposed Rule 6250(a)(1) and (2). For example, NASD will require a member to provide the date and time that the new TRACE-eligible security was priced. NASD is also proposing minor technical amendments to Rule 6260.

V. Miscellaneous

With the intent of providing transaction information on a more flexible basis to better meet the changing needs of the market place, NASD is proposing to delete the provisions in Rule 6250 relating to the administration, calculation, and dissemination of “market aggregate” and “last sale” data for disseminated securities, and the treatment of TRACE-eligible securities traded after the TRACE System has closed or on a non-business day. Specifically, NASD is proposing to delete current paragraph (b) of Rule 6250, entitled, “Transactions Excluded From Market Aggregate, Last Sale,” paragraph (c) of Rule 6250, entitled, “Dissemination of Certain Trades Executed on A Business Day,” and paragraph (d) of Rule 6250, entitled, “Dissemination of Trades Executed on Non-Business Day.” NASD will establish policies for the administration, calculation and dissemination of “market aggregate” and “last sale” data that will incorporate the concepts set forth in the proposed amendments to Rule 6250 providing for both immediate and delayed dissemination of transaction information. NASD will publish information concerning

the above in various media (e.g., Notice to Members, TRACE User's Guide and the NASD website).

NASD will continue to treat transactions described in paragraphs (c) and (d) of Rule 6250 in the same manner as set forth in the Rule, provided the treatment is consistent with the proposed amendments to Rule 6250 requiring delayed dissemination and continues to meet the needs of the market place. The treatment of transactions executed after the TRACE System closes, and on weekends and holidays will be set forth in a published policy. Again, NASD will publish information concerning the above in various media (e.g., Notice to Members, TRACE User's Guide and the NASD website).

VI. Implementation of Proposed Dissemination Amendments

Staged Implementation

As noted above, NASD is proposing that the dissemination provisions be implemented in two stages because NASD must make significant operational and technical enhancements to the TRACE System, to implement certain aspects of the proposal.

Stage One. As Stage One, NASD will implement the following portions of the proposed rule change: the proposed amendments to Rule 6210 (definitions); Rule 6250(b)(1)(A) and (B), requiring immediate dissemination of all Investment Grade TRACE-eligible securities transactions, except transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BBB (or the equivalent rating of one or more NRSROs) that occur during a New Issue Aftermarket-2; under Rule 6250(b)(1)(C)(i), all TRACE-eligible securities transactions of \$1 million or less (par value) subject to dissemination, except those where the subject security does not meet the frequency standard set forth in Rule

6250(b)(1)(C)(ii);<sup>25</sup> Rule 6250(b)(1)(C)(ii), requiring immediate dissemination of all transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower that exceed \$1 million (par value) and meet the frequency test set forth in this subsection; Rule 6250(c), prohibiting the dissemination of Rule 144A transactions; and Rule 6260, providing for new issue notifications. In addition, Stage One will include the proposed deletions of current Rule 6250(a) through (d). Stage One will become effective on September 1, 2004.

Stage Two. Stage Two will consist of the implementation of proposed Rule 6250(a), providing for delayed dissemination of transaction information for transactions occurring during a New Issue Aftermarket-2 or New Issue Aftermarket-10, as defined above; the portion of proposed Rule 6250(b)(1)(C)(i) not fully implemented in Stage One;<sup>26</sup> and proposed Rule 6250(b)(2), providing for delayed dissemination of transaction information in certain transactions in TRACE-eligible securities rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower.

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<sup>25</sup> Rule 6250(b)(1)(C)(i) provides for the immediate dissemination of transactions in TRACE-eligible securities that are rated by an NRSRO or classified by NASD for purposes of TRACE as BB (or the equivalent rating of one or more NRSROs) or lower and are executed other than during the New Issue Aftermarket-10, if the size of the transaction is \$1 million or less. NASD intends to partially implement this provision in Stage One. In Stage One, NASD proposes to disseminate immediately such transactions in *any security* for which the larger transactions (i.e., “\$1 million plus” transactions) are also disseminated in Stage One (i.e., securities that are traded an average of one or more times per day, as more fully set forth in Rule 6250(b)(1)(C)(ii)). Securities transactions described in Rule 6250(b)(1)(C)(i) that would otherwise be subject to immediate dissemination, but occurred in a security that was traded an average of less than one time per day and is subject to the delayed dissemination provisions in Rule 6250(b)(2)(A)(ii) or Rule 6250(b)(2)(B)(ii), will be disseminated in Stage Two, when delayed dissemination is functional and all transactions in the security will be disseminated. For example, XPL Security is rated BB (or the equivalent rating of one or more NRSROs) and trades an average of less than one time per day. Under Rule 6250(b)(1)(C)(i), a transaction in XPL Security for \$100,000 would be disseminated immediately if not for the above approach to implementation, but a transaction on the same day in XPL Security for \$2 million would not be disseminated at any time during Stage One. NASD intends to withhold the dissemination of the \$100,000 transaction in XPL Security during Stage One because it believes that all market participants will be best served and get a more complete and accurate indication of price when transactions of all sizes in a security are disseminated.

<sup>26</sup> Id.

NASD is implementing these provisions as Stage Two, because the provisions cannot become effective until NASD has enhanced the TRACE System. By phasing the proposed rules in using two stages, NASD will not delay the implementation of nearly all of the dissemination provisions in Rule 6250(b)(1), which will have the greatest impact on increasing transparency. Stage Two will become effective on December 1, 2004.

Planned Review Nine Months After Stage Two Implementation

Finally, as discussed previously, NASD intends to continue to review the trading and the liquidity in TRACE-eligible securities during the implementation of Stages One and Two of the proposed rule change. As part of this review process, not later than nine months from the implementation of Stage Two, NASD will ask the BTRC to reconvene to review the rule. Based on the reviews, the BTRC and NASD staff will make recommendations to the NASD Board. The NASD Board will review the recommendations and will decide whether to amend the dissemination provisions then in effect.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the 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 believes that the proposed rule change will provide NASD with heightened capabilities to regulate and provide surveillance of the debt securities markets to prevent fraudulent and manipulative acts and practices, and will improve transparency in the debt securities markets for the benefit of customers and other market participants in furtherance of the public interest and for the protection of investors.

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

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Written comments were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. by order approve such proposed rule change, or

B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the act. 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. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-NASD-2004-XX. This file number should be included on the subject line if e-mail is used. To help us process and review comments more

efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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 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).

Margaret H. McFarland  
Deputy Secretary