

August 6, 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 TRACE-Eligible Securities and Facilitate Dissemination; Amendment No. 1 and Response to Comments

Dear Ms. England:

NASD, Inc. (“NASD”) hereby responds to the comment letters received by the Securities and Exchange Commission (“Commission” or “SEC”) in response to the publication in the *Federal Register* of Notice of Filing of SR-NASD-2004-094.¹ In addition, NASD hereby submits Amendment No. 1 to SR-NASD-2004-094.

In SR-NASD-2004-094, NASD proposes changes to: (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 securities² 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 various notification provisions and require information needed to implement various dissemination schedules, and to make certain minor, technical changes. NASD also proposes that the amendments to Rule 6250 be implemented in two stages (“Stage One” and “Stage Two”), and that not later than nine months after the implementation of Stage Two, 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.

¹ Securities Exchange Act Release No. 49920 (June 25, 2004), 69 Fed. Reg. 40429 (July 2, 2004). The public comment period announced in the *Federal Register* expired on July 23, 2004.

² Under the proposed rule change, all transactions in TRACE-eligible securities will be disseminated, except transactions in TRACE-eligible securities that are issued pursuant to Section 4(2) of the Securities Act of 1933 (“Securities Act”) and purchased or sold pursuant to Rule 144A under the Securities Act.

The Commission received one comment letter in response to the *Federal Register* publication of SR-NASD-2004-094.³ The comments submitted to the Commission are summarized below.

Harm to Liquidity

The commenter states that the proposal does not adequately address continuing concerns about harm to liquidity in the corporate bond market. Specifically, the commenter argues that the proposal does not adequately preserve the anonymity of large investors in sectors of the TRACE-eligible securities market that include lower-rated or infrequently traded securities and may result in reduced liquidity and a reluctance by dealers to commit capital to facilitate transactions in those sectors.

Three aspects of the dissemination provisions are criticized. First, the commenter opposes a dissemination delay of two to four business days for lower-rated, infrequently traded TRACE-eligible securities. Second, the commenter opposes the immediate dissemination of all BBB-rated TRACE-eligible securities, arguing that transactions in BBB-rated bonds that are infrequently traded and trade at yields significantly higher than the typical BBB-rated bonds should be subject to a two-business day delay. Third, the commenter states that in determining the frequency of trading in a TRACE-eligible security, NASD should not count all trades. Instead, NASD's determination of the frequency of trading should be modified to count only large trades (*i.e.*, trades over \$1 million par value).

NASD believes that the proposed dissemination provisions strike a well-reasoned balance between the liquidity concerns cited by the commenter and the substantial benefits of increased transparency to all segments of the market place, and most specifically, the investing public. NASD believes that existing transparency has brought substantial benefits to the market in TRACE-eligible securities, and strongly believes that the complete transparency resulting from the proposed dissemination provisions is warranted. In addition, all proposed dissemination provisions were developed and supported by the Bond Transaction Reporting Committee ("BTRC").⁴ During this process all proposed dissemination provisions were thoroughly vetted and discussed, and the provisions reflect the expertise and input of the BTRC. Furthermore, after extensive examination of approximately 18 months of TRACE data and a review of two studies performed by a team of econometricians, NASD found no conclusive evidence that TRACE transparency has adversely affected liquidity, including the liquidity in lower-rated TRACE-eligible securities.

³ Letter from Donald R. Mullen, Jr., Goldman Sachs & Co., Chair, Corporate Credit Market Division, The Bond Market Association, to Jonathan G. Katz, Secretary, SEC, dated July 23, 2004.

⁴ The BTRC 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.

Finally, as noted in the proposal, NASD intends to continue to review the trading and liquidity in TRACE-eligible securities during the two stages of implementation of the proposed rule. As part of this review process, within nine months of the implementation of Stage Two NASD will ask the BTRC to reconvene to review the dissemination provisions. Based on the reviews, the BTRC and NASD staff will make recommendations to the NASD Board. The NASD Board will review the recommendations and decide whether to amend the dissemination provisions then in effect.

Expedited Change in Dissemination Protocol If Liquidity is Adversely Affected

The commenter argues that NASD should plan to seek adjustments to the dissemination provisions on an expedited basis to revise the dissemination protocol of a particular group of TRACE-eligible securities if NASD determines that dissemination is having an adverse impact on the liquidity of such securities. In addition, NASD should conduct a thorough, ongoing review of relevant TRACE and market data. Finally, the commenter calls for a mechanism to enable the BTRC to be convened immediately if market conditions necessitate (*i.e.*, convening prior to meeting as anticipated within nine months after the implementation of Stage Two).

As stated above, NASD intends to continue to review the trading and liquidity in TRACE-eligible securities during the Stage One and Stage Two implementation of the proposed rule change. In addition, NASD has authority to effect necessary amendments to relevant NASD rules to protect the integrity of the corporate bond market. The input of industry experts, including the views of the diverse membership of the BTRC, has been essential to the development of the proposed dissemination provisions, and NASD staff will continue to involve knowledgeable industry participants to inform and aid it in its continuing assessment of the impact of dissemination on trading and liquidity in the market for TRACE-eligible securities. In this regard, NASD's approach is to retain the flexibility to seek the advice of the membership of the BTRC or reconvene the BTRC formally as needed.

Public Availability of TRACE Trade Data

The commenter argues that NASD should make its consolidated transaction data available to all market participants so that market participants can use the data to assess the effects of transparency on liquidity. Such information will be available. As part of its transparency mandate, NASD, as is currently its practice, will make transaction information for all publicly disseminated TRACE-eligible securities available through its website, vendors, or via an electronic feed directly from NASD.

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Amendment No. 1

Initially NASD proposed to implement the proposed rule change in two stages. The portions of the proposed rule change that would be implemented as Stage One⁵ would become effective on September 1, 2004, and the remaining portions of the proposed rule change would be implemented as Stage Two on December 1, 2004.⁶ NASD proposed that the dissemination provisions be implemented in this manner because NASD would be required to make significant operational and technical enhancements to the TRACE System to implement certain aspects of the proposal.

In this Amendment No. 1, NASD proposes to amend the effective dates of Stage One and Stage Two. NASD proposes to make Stage One effective not later than 60 days after the date of the Commission's approval of the proposed rule change, which will allow NASD to give timely notice to members and vendors of the amended dissemination provisions, and allow them to make system changes as needed. In addition, NASD proposes to make Stage Two effective on February 1, 2005, which will provide NASD the additional time needed to make the significant operational and technical enhancements to the TRACE System to accommodate the proposal to disseminate virtually all transactions in TRACE-eligible securities, yet provide for the delayed dissemination of certain transactions.

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⁵ The portions of the proposed rule change that will be implemented as Stage One are: 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 in the proposed rule change; 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); 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 therein; Rule 6250(c), prohibiting the dissemination of Rule 144A transactions; and Rule 6260, providing for new issue notifications. In addition, Stage One includes the proposed deletions of current Rule 6250(a) through (d).

⁶ The portions of the proposed rule change that will be implemented as Stage Two are: 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 in greater detail in the proposed rule change; the portion of proposed Rule 6250(b)(1)(C)(i) not fully implemented in Stage One; 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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If you have any questions, please feel free to contact Sharon Zackula, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8985; e-mail sharon.zackula@nasd.com, or Elliot Levine, Chief Counsel and Senior Advisor, Markets, Services, and Information, at (202) 728-8405; e-mail elliott.levine@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

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