

BY HAND

November 17, 2000

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

Re: File No. SR-NASD-99-65, Amendment No. 2
Proposal to Require Reporting and Dissemination
of Fixed Income Transactions (*TRACE*) and
Response to Comments

Dear Ms. England:

Pursuant to Rule 19b-4, the National Association of Securities Dealers, Inc. (*NASD*) is filing this letter Amendment No. 2¹ to respond to comments received by the Securities and Exchange Commission (*SEC* or *Commission*) with respect to SR-NASD-99-65. SR-NASD-99-65 was published in Securities Exchange Act Release No. 42201 (Dec. 3, 1999), 64 FR 69305 (Dec. 10, 1999). The filing of this Amendment No. 2 was authorized by the NASD Board of Governors on October 5, 2000. The revised text of the proposed rules is set forth in attached Exhibit 2. 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.

The revisions reflect certain changes proposed by the commenters or suggested by the NASD staff after additional review. For convenience, the proposed NASD Rules in this Amendment No. 2 are referred to as the *TRACE* Rules, in reference to the proposed facility, which is currently referred to as the Trade Reporting and Comparison Entry Service (*TRACE*).²

INTRODUCTION

¹ NASD previously submitted Amendment No. 1 to reflect the Association's receipt of written comments from the Regional Municipal Operations Association (*RMOA*). After consultation with the Commission staff, NASD withdrew Amendment No. 1 and has incorporated RMOA's comments and the NASD's response in this amendment. As explained in SR-NASD-99-65, NASD will file a separate proposal to establish appropriate fees and charges for *TRACE* prior to implementation.

² NASD will rename *TRACE*. When a new name is selected, the NASD will amend the *TRACE* Rules prior to implementation of the service to reflect that name change.

In 1998, SEC Chairman Arthur Levitt, in recognition of the relative lack of transparency in the corporate debt market, called upon the NASD to do the following: (1) adopt rules requiring NASD members to report all transactions in corporate bonds to the NASD and to develop systems to receive and distribute transaction prices on an immediate basis; (2) create a database of transactions in corporate bonds to enable regulators to take a proactive role in supervising the corporate debt market; and (3) create a surveillance program, in conjunction with the development of a database, to better detect fraud and foster investor confidence in the fairness of the corporate debt market. The NASD, after extensive consultation with industry professionals, filed SR-NASD-99-65. The NASD also consulted extensively with industry professionals again before filing this Amendment No. 2.

As with any change affecting long-standing practices of market participants, TRACE has generated significant comment. The NASD has identified six common areas in the comment letters: (1) TRACE ownership, operation, and governance; (2) the proposed comparison function; (3) collection and dissemination of data; (4) TRACE data; (5) implementation schedules; and (6) T + 1 clearance and settlement and straight-through-processing (*STP*) issues. These issues are addressed below. In addition, the NASD is proposing to add bond yield as a mandatory element of reporting, which is discussed as item (7) below.

1. TRACE Ownership, Operation and Governance

As noted above, at the request of the SEC, the NASD has proposed to create a system for the reporting, dissemination and surveillance of fixed income transactions. Many commenters expressed concern about, or requested further information regarding, the roles and responsibilities of NASD and Nasdaq in this initiative. In response to those concerns, the NASD will take the following steps to clarify the roles of NASD, NASD Regulation, and Nasdaq.

- (1) The NASD will amend proposed TRACE Rule 6210 to clarify that it is the owner and operator of the facility, TRACE, to collect information on fixed income transactions and to disseminate such information;
- (2) The NASD will file an application with the SEC to become registered as a exclusive securities information processor (*ESIP*) under Section 11A of the Exchange Act;
- (3) The NASD, with the approval of the NASD Board of Governors, will establish a body of rules and policies that will be the bases on which NASD staff will administer the reporting and dissemination facility and assure compliance with the TRACE Rules;
- (4) NASD Regulation will aid the NASD in establishing appropriate regulatory rules and policies and in performing all the regulatory functions associated with TRACE; and

- (5) Nasdaq will provide technology and operational support pursuant to a contractual arrangement.

The NASD believes that the structure outlined above is responsive to many of the concerns raised by commenters. The NASD, the sole self-regulatory organization (SRO) for the over-the-counter (OTC) markets, will exercise full ownership and operational control over the TRACE project, including day-to-day administration and the information collection process. The NASD will become an ESIP under Section 11A of the Exchange Act, providing the appropriate regulatory oversight by the SEC of the NASD's operations, administration, and fees. At the same time, the NASD will be able to employ Nasdaq as its vendor of information processing services, which allows NASD to take advantage of Nasdaq's prior experience, yet exercise appropriate regulatory and administrative control over the collection of the information, the fees charged, the selection of vendors, and other important administrative and regulatory matters. This structure parallels the structure used by other registered ESIPs under Section 11A, such as the Consolidated Tape Association (CTA) and Options Price Reporting Authority (OPRA). For example, the CTA, for purposes of Networks A and B, and OPRA, for purposes of options information, obtain information processing services by agreement with SIAC, and do so without decreasing their control or ceding such control to SIAC.

Although ultimate statutory authority will reside with the NASD Board of Governors, to more fully incorporate bond market expertise into TRACE operations and decision-making, the NASD proposes to create a new committee, the Bond Transaction Reporting Committee (BTRC), to advise the NASD Board. BTRC would consist of 8 persons selected by the NASD Board. Four of the members will be recommended by the staff of the NASD, and the other four members will be recommended by The Bond Market Association (TBMA). Selections would not include current staff or officers of either the NASD or TBMA. Both the NASD and TBMA would commit to having their selections consist of a broad range of bond market participants and include public representation. BTRC would provide significant input to the NASD Board on issues related to the operation of TRACE, including future NASD proposals to phase in dissemination and the setting of fees for dissemination of real-time TRACE data to the public. In addition, BTRC will be tasked with reviewing the effects upon liquidity associated with the dissemination of fixed income transaction information. BTRC will make recommendations to the NASD Board concerning appropriate time frames for public dissemination of smaller, less-actively traded issues.

The NASD Board will give significant weight to the advice and recommendations of BTRC. The formation and operation of BTRC, however, shall in no way limit or hinder the responsibility and ability of the NASD Board to make final decisions, as required in accordance with the statutory obligations and responsibility articulated in Section 15A of the Exchange Act and the NASD By-Laws. In addition, the NASD staff may continue to make independent recommendations or proposals to the NASD Board concerning bond market issues.

In addition to concerns expressed by some commenters about the role of Nasdaq in the TRACE initiative, other commenters suggested that a super-utility, rather than the NASD or Nasdaq, be used to collect fixed income transaction information. Others suggested the creation of a new SRO or vesting that authority in the NSCC. Since the NASD is the SRO charged with regulating the OTC markets and 95% of corporate bond transactions occur in the OTC market, the NASD is the SRO most appropriately situated to undertake this regulatory initiative and to assure compliance with it. Creating a super-utility or a new SRO would not be cost-effective, would result in regulatory duplication and duplicative fees to the industry, and would delay greatly the implementation of reporting and dissemination.

Finally, one set of commenters, consisting of a data vendor and securities exchange, urged the Commission to adopt a de-centralized, multiple SRO-collector and disseminator model for fixed income transaction reporting. These commenters assert that such a model would encourage innovation and competition among organizations for the collection, comparison and dissemination of corporate bond trade data. While the NASD agrees that competition is an important goal, the Commission and Congress have long recognized that in the area of collection, consolidation, and dissemination of market data information, other factors, such as equality of access, reasonableness of fees, and sufficient system capacity and security, are equally important.

2. Trade Comparison

Some commenters expressed concern that the proposal would mandate that all corporate bond trade comparison take place within TRACE. Among other things, commenters objected to mandated comparison through TRACE because, they argued, it would result in Nasdaq having an exclusive franchise over the provision of comparison services for corporate bond trades.

The proposal to require mandatory comparison through TRACE was intended to ensure that the corporate bond trade data reported to and disseminated by the NASD was as accurate as possible, as evidenced by the acceptance of the trade by both parties. In addition to the fact that the NASD, not Nasdaq, will own and control TRACE, to further alleviate concerns expressed by the commenters, the NASD proposes to delete the TRACE Rules regarding trade comparison as shown in attached Exhibit 2. (The NASD also proposes to delete the risk management provisions as shown in attached Exhibit 2.) Although NASD plans to offer voluntary comparison services to NASD members, firms will be free to select other entities to compare their transactions in TRACE-eligible securities. The elimination of mandatory comparison through TRACE will provide an opportunity for other entities to offer competing value-added comparison services for fixed income transactions.

As a result of this amendment, both compared and un-compared corporate bond trade data will be disseminated by the NASD. The NASD will amend the proposal further to require TRACE participants, whether reporting or non-reporting members, to provide to the NASD the same data on TRACE-eligible securities transactions that is provided to the member's registered

clearing agency, within the same time frame and, to the extent possible, in the same format. (Exhibit 2, proposed TRACE Rule 6231.) This requirement is in addition to a member's obligation, if any, to report a fixed income transaction on a real-time basis under proposed TRACE Rule 6230. The NASD believes that this will improve considerably the quality of the data for surveillance purposes, while imposing minimal additional burdens on the firms.

3. Collection and Dissemination of TRACE Data

The NASD originally proposed a reporting plan that began first with high yield and convertible debt securities, followed by an alphabetical phase-in of all other TRACE-eligible corporate bonds. The initial time frame proposed for reporting trades would be no later than 1 hour after trade execution, which subsequently would be reduced to 15 minutes. After a brief start-up period during which the NASD would conduct a data integrity review, all eligible trade reports received would thereafter be disseminated immediately, subject to TRACE's proposed limitations on reporting the actual size of large transactions to the public through data vendors.

Some commenters raised concerns that this plan failed to take into account the potential negative impact on liquidity that immediate dissemination of bond transaction reports could have on smaller, less-actively traded issues. Additional concerns were raised regarding likely confusion relating to trade reporting obligations in a plan that involved multiple phases and categories of fixed income securities. In response, the NASD has determined to propose a new phase-in methodology. Under this new approach, a member's obligation to report and the NASD's initial dissemination of reports in TRACE-eligible securities will take place as follows:

Phase I - Three Months in Length

- NASD members will be required to report all transactions in TRACE-eligible securities within 1 hour of trade execution.
- NASD will immediately disseminate transaction reports to the public and data vendors of all transactions in publicly offered, investment grade corporate bonds having an initial issuance size of \$1 billion or greater. If applicable, these reports will be disseminated using the large volume trade dissemination cap identifiers (*i.e.*, "1MM+" for high yield securities and "5MM+" for investment grade corporate bonds) that were proposed in NASD's original TRACE filing.
- Transaction reports in the high yield debt securities denominated as the "FIPS 50" at the time the filing becomes effective will also be disseminated -- also using the "1MM+" large volume trade dissemination cap identifier.
- BTRC will commence its examination of the impact of TRACE's transaction dissemination on liquidity. By the end of Phase I (three months after the start of TRACE

reporting), BTRC will provide its recommendations for appropriate dissemination protocols covering those investment grade bonds, starting with the largest issuance size, that, when combined together, make up the top 50% (by dollar volume) of such bonds.

Phase II - Six Months in Length

- NASD members will continue to be required to report all transactions in TRACE-eligible securities within 1 hour of trade execution.
- The NASD will disseminate transaction reports to the public and data vendors of all transactions in the top 50% (by dollar volume) of investment grade bonds consistent with the recommendations of BTRC (subject to the approval of the NASD Board and the SEC).³ If applicable, these reports will be disseminated, subject to using the large-volume trade dissemination cap identifiers (*i.e.*, “1MM+” for high yield securities and “5MM+” for investment grade securities) that were proposed in NASD's original TRACE filing.
- Three months after the start of Phase II (six months after the start of TRACE reporting), the 1 hour maximum time period to submit TRACE trade reports will be reduced to 15 minutes, subject to the ability of firms to comply technologically and operationally.
- Transaction reports in the "FIPS 50" will continue to be disseminated -- also using the large volume trade dissemination cap identifiers (*i.e.*, “1MM+”).
- BTRC will continue its evaluation of the impact that dissemination of transaction information has on liquidity. By the end of Phase II (9 months after the start of TRACE reporting), BTRC will provide recommendations for appropriate dissemination protocols for all remaining TRACE issues eligible for public dissemination.

During all phases, BTRC continually will evaluate industry technological readiness with a view to reducing further the post-execution deadlines for submitting trade reports to TRACE. The NASD believes that this new approach to collecting and disseminating real-time market data draws an appropriate balance between the Commission's desire for quick and measurable progress in improving transparency in the corporate bond market and industry concerns about liquidity. Moreover, the new approach captures more information for regulatory purposes in a shorter time frame than under NASD's earlier TRACE transaction reporting plan. In turn, the

³ Trade reports for Rule 144A securities will not be considered as part of the total average daily volume of the TRACE system for purposes of Phase II. In addition, the NASD notes that the proposed Phase II formula will result in an overlap with Phase I securities that may reduce the number of newly disseminated bonds in the second phase. NASD will ask BTRC to review the Phase II dissemination formula in more detail to determine if a different approach to expanding the universe of disseminated bonds in Phase II is appropriate.

new approach will allow NASD more quickly to develop and refine its surveillance plan for the fixed income market.

4. TRACE Data

Many commenters raised concerns that TRACE would grant the NASD exclusive control over corporate bond trade data. The NASD, in response to concerns raised regarding such exclusive control, intends to register as an ESIP under Section 11A of the Exchange Act. As explained in the SEC's release entitled, *Regulation of Market Information Fees and Revenues*, Securities Exchange Act Release No. 42208 (Dec. 9, 1999), 64 FR 70613 (Dec. 17, 1999), in furtherance of national market system goals, the SEC recognizes the structure in which one central information processor receives and consolidates market "information into a single stream for dissemination to the public." 64 FR 70613, 70615. Regarding this consolidated data stream, the SEC stated, "the practical effect of comprehensive federal regulation of market information is that proprietary interests in this information are subordinated to the Exchange Act's objectives for a national market system." *Id.*

The SEC exercises oversight over the information consolidator by requiring registration of the consolidator as an ESIP under Section 11A of the Exchange Act, and regulating the registered ESIP's conduct. Under Section 11A, the NASD, as the registered ESIP, will be obligated to deliver market information on terms that are fair and reasonable. The SEC must assure that TRACE will meet all of the obligations imposed on ESIPs, including capacity, redundancy, audit trail, and surveillance capabilities. The NASD solely will be responsible for establishing rules and fees related to the sale of real-time data dissemination. Nasdaq, which will not be the ESIP, will not possess any ownership rights in TRACE data, and will not exercise any control over the TRACE project. Nasdaq's role will be that of a contractor, providing to the NASD the collection and dissemination systems that will enable the NASD to perform its SRO functions.

5. Implementation Schedules

The NASD has discussed TRACE's implementation with various members, vendors, and industry groups to understand the likely amount of time necessary to implement the regulatory reporting and transparency aspects of TRACE. After extensive discussions with corporate bond market participants, the NASD has determined to modify its original filing and seek SEC approval to begin Phase I of TRACE 180 days following SEC approval of the service. NASD believes that this additional time will allow its members to better prepare for the advent of TRACE trade reporting as well as give NASD sufficient time to more fully test TRACE technology.

6. T + 1 Clearance and Settlement and STP Issues

Many commenters raised concerns about how TRACE fits into ongoing industry initiatives to facilitate a T+1 clearance and settlement cycle anticipated in 2004 and later, straight-through processing (STP). The NASD believes that TRACE provides significant tools to the fixed income industry to assist them in moving to a T+1 settlement cycle. When implemented, TRACE's real-time comparison and forwarding features will give market participants a fast, efficient way to enter their "locked-in" trade reports into the trade processing system and allow for faster settlement. TRACE's open system architecture provides multiple ways of entering trade reports and also ensures that these powerful tools will be available to all firms regardless of size. The NASD is committed to the concept of interoperability between its systems and others operated by national and international clearing entities. In the final analysis, however, the pressing need for improved transparency in the corporate bond market cannot be subordinated to the much more complex and long-term goals of global straight-through processing. As always, NASD will continue to take action to ensure that its systems remain the most flexible and open possible, as well as being capable of quickly and efficiently adapting to whatever STP standards and protocols are adopted in the future.

7. Addition of a Yield Value to TRACE Trade Reports

As a result of further internal NASD review regarding the proper elements of a fixed income transaction report, the NASD has determined to add a yield requirement to TRACE trade reports. The NASD believes that the addition of a yield value, determined in conformity with Rule 10b-10 under the Exchange Act, provides a valuable mechanism to match, verify, and analyze pricing of corporate bonds. The NASD notes that firms are already required to provide this information to customers as part of the transaction confirmation process and believes that any additional burden on firms to enter such information is more than offset by the regulatory value of such information. Specifically, yield information will enable the NASD to identify potentially erroneous fixed income transactions on a real time basis, thereby promoting the integrity of the transactions reports. The proposed rule change is shown in attached Exhibit 2.

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CONCLUSION

The NASD's principal goal in developing TRACE is to meet the mandate of the SEC to provide greater transparency to investors and to enhance the NASD's regulatory oversight of corporate bond trading. The NASD believes it has responded in a flexible and proactive manner to various industry concerns regarding TRACE.

If you have any questions, please contact Sharon Zackula, Office of General Counsel, NASD Regulation, Inc., at 202-728-8985; e-mail sharon.zackula@nasd.com; fax number 202-728-8264.

Sincerely,

Joan C. Conley
Senior Vice President
and Corporate Secretary

Enclosures

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Proposed new additions are underlined, proposed new deletions are in brackets.

6200. TRADE REPORTING AND COMPARISON ENTRY SERVICE (TRACE)

6210. Definitions

The terms used in this [paragraph] Rule 6200 Series shall have the same meaning as those defined in the Association's By-Laws and Rules unless otherwise specified.

(a) The term ["TRACE Eligible Security"] "TRACE-eligible security" shall mean all United States dollar denominated debt securities that are registered with the Securities and Exchange Commission and issued by United States and/or foreign private corporations and that are depository eligible securities as defined in Rule 11310(d); all debt securities qualified as PORTAL securities pursuant to the Rule 5000 Series; all investment-grade rated debt securities that are issued pursuant to Section 4(2) of the Securities Act of 1933 and that are depository eligible securities pursuant to Rule 11310(d).

(b) The term "Trade Reporting And Comparison Entry Service" or "TRACE" shall mean the automated system owned and operated by the NASD [The Nasdaq Stock Market, Inc.] that, among other things, accommodates reporting[, comparison,] and dissemination of transaction reports where applicable in TRACE-eligible securities [Securities] and which may submit "locked-in" trades to National Securities Clearing Corporation for clearance and settlement and provide participants with monitoring and risk management capabilities to facilitate a "locked-in" trading environment.

(c) The term "reportable TRACE transaction" shall mean [all] any transaction[s] in a TRACE-eligible security [Eligible Security as required by this rule].

(d) The term "time of execution" for a transaction in a TRACE-eligible security shall be the time when the parties agree to all of the terms of the transaction [are agreed to which] that are sufficient to calculate the dollar price of the trade. The time of execution for transactions involving TRACE-eligible securities that are trading "when issued" on a yield basis shall be when the yield for the transaction has been agreed to by the parties.

(e) The term ["Parties to the Transaction"] "parties to the transaction" shall mean the executing broker/dealer, introducing broker/dealer, and clearing brokers, if any.

(f) The term "TRACE Participant" shall mean any NASD member [in good standing] that uses the TRACE system.

[(g) The term "TRACE Reporting Party" shall mean a member of the Association that is registered as a TRACE participant with the Association and obligated to report a TRACE transaction pursuant to TRACE system rules and who is member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member.]

[(h) The term "TRACE Non-Reporting Party" shall mean a member of the Association that is registered as a TRACE participant with the Association who is not obligated to report under TRACE system rules for a particular transaction to which it is a party and who is member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member. It shall also mean any customer who is not a member of the Association.]

[(i) The term "Clearing Broker/Dealer" or "Clearing Broker" shall mean the member firm that has been identified in the TRACE system as principal for clearing and settling a trade, whether for its own account or for a correspondent firm.]

[(j) The term Correspondent Executing Broker/Dealer” or “Correspondent Executing Broker” shall mean the member firm that has been identified in the TRACE system as having a correspondent relationship with a clearing firm whereby it executes trades and the clearing function is the responsibility of the clearing firm.]

[(k)] (g) The term [“Introducing Broker/Dealer” or “introducing broker”] “Introducing Broker” shall mean the member firm that has been identified in the TRACE system as a party to the transaction, but does not execute or clear trades.

[(l) The term "Browse" shall mean the functions of TRACE that permit a Participant to review (or query) for trades in the system identifying the Participant as a party to the transaction, subject to the specific uses contained in the TRACE Users Guide.]

[(m) The term “Gross Dollar Thresholds” in the risk management application of TRACE shall mean the daily dollar amounts for purchases and sales that a clearing broker establishes in the TRACE system for each correspondent executing broker that may be raised or lowered on an inter-day or intra-day basis. If the value of a correspondent’s trades equals or exceeds the gross dollar thresholds, the system will alert the clearing broker.]

[(n) The term “Pre-alert” shall mean the alert notifying the correspondent executing broker and the clearing broker that the correspondent executing broker has equaled or exceeded 70% of the purchase or sale gross dollar limits established by the clearing broker. The Association reserves the right to modify the percentage of the pre-alert as necessary and upon prior notification to the TRACE Participants.]

[(o) The term "Single Trade Limit" shall mean the dollar amount established by the Clearing Broker for a single trade that enables a TRACE clearing firm to review the trade before it is obligated to clear the trade. When a correspondent executing broker negotiates a trade that equals or exceeds the Single Trade Limit, its clearing broker shall have a period of thirty (30) minutes to review and agree or decline to act as principal for clearing that trade. If a Clearing Broker fails to set a single trade limit the TRACE system will automatically set a default single trade limit of \$0 for the Correspondent Broker. The Association reserves the right to modify the minimum/maximum dollar amount of the Single Trade Limit as well as the time frame for clearing broker review as necessary and upon prior notification to the TRACE Participants.]

[(p)] (h) [For purposes of these rules, the] The term "Investment Grade" shall mean any TRACE-eligible security rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories.

[(q)] (i) [For purposes of these rules, the] The term "Non-Investment Grade" shall mean any TRACE-eligible security that is unrated, non-rated, split-rated (where one rating falls below investment grade), or does not meet the definition of [investment grade]

Investment Grade in paragraph [(p)] (h)[,] above.

6220. Participation in TRACE

(a) Mandatory Member Participation [for Clearing Agency Members]

(1) [Pursuant to Article VII, Section 1(a)(vi) and (vii) of the By-Laws, participation in TRACE is mandatory for all brokers/dealers that are members of a clearing agency registered with the Commission pursuant to Section 17A of the Act, and for all brokers

that have a clearing arrangement with such a broker. Such participation shall include the reconciliation of all over the counter clearing agency eligible transactions involving TRACE securities.] Member participation in TRACE for trade reporting purposes is mandatory. Such mandatory participation obligates members to submit transaction reports in TRACE-eligible securities in conformity with the Rule 6200 Series.

(2) Participation in TRACE shall be conditioned upon the TRACE Participant's initial and continuing compliance with the following requirements:

(A) execution of, and continuing compliance with, a TRACE Participant Application Agreement and all applicable rules and operating procedures of the Association and the Commission; and

[(B) membership in, or maintenance of, an effective clearing arrangement with a member of a clearing agency registered pursuant to the Act;]

[(C)] (B) maintenance of the physical security of the equipment located on the premises of the TRACE Participant to prevent unauthorized entry of information into TRACE₂[: and]

[(D) acceptance and settlement of each trade that TRACE identifies as having been effected by such TRACE Participant, or if settlement is to be made through a clearing member, guarantee the acceptance and settlement of each TRACE identified trade by the clearing member on the regularly scheduled settlement date.]

[(3) Participation in TRACE as a Clearing Broker shall be conditioned upon the Clearing Broker's initial and continuing compliance with the following requirements:]

[(A) execution of, and continuing compliance with, a TRACE Participant Application Agreement and all applicable rules and operating procedures of the Association and the Commission;]

[(B) membership in a clearing agency registered pursuant to the Act;]

[(C) maintenance of the physical security of the equipment located on the premises of the TRACE Clearing Broker to prevent the unauthorized entry of information into TRACE; and]

[(D) acceptance and settlement of each trade that TRACE identifies as having been effected by itself or any of its correspondents on the regularly scheduled settlement date.]

[(4)] (3) Each TRACE Participant shall be obligated to inform the Association of non-compliance with, or changes to, any of the participation requirements set forth above.

(b) Participant Obligations in TRACE

(1) Access to TRACE

Upon execution and receipt by the Association of the TRACE Participant Application Agreement, a TRACE Participant may commence input and validation of trade information in TRACE-eligible securities. TRACE Participants may access the service via an NASD-approved facility during the hours of operation.

(2) Clearing Obligations

If at any time a TRACE Participant fails to maintain a clearing arrangement, it shall be removed from the TRACE system until such time as a clearing arrangement is re-

established and notice of such arrangement is provided to the Association. If, however, the Association finds that the TRACE Participant's failure to maintain a clearing arrangement is voluntary, the withdrawal will be considered voluntary and unexcused. This section shall not apply to TRACE Participants whose trading activity obviates the need for maintaining a clearing relationship.

[(3) Clearing Broker Obligations]

[(A) Clearing brokers may cease to act as principal for a correspondent executing broker at any time provided that notification has been given to, received and acknowledged by the TRACE Operations Center and affirmative action has been completed by the Center to remove the correspondent broker from TRACE. The clearing broker's obligation to accept and clear trades for its correspondents shall not cease prior to the completion of all of the steps detailed in this subparagraph (3).]

[(B) TRACE Clearing brokers shall establish for each correspondent executing broker daily Gross Dollar Thresholds and may raise or lower the thresholds on an inter-day or intra-day basis. TRACE clearing brokers will receive a system alert when a correspondent executing broker equals or exceeds its gross dollar thresholds and will also receive a system pre-alert when a correspondent executing broker equals or exceeds 70% of the daily thresholds.]

[(C) For trades effected by a correspondent executing broker that equal or exceed the correspondent's Single Trade Limit set by the clearing broker in TRACE, clearing brokers have 30 minutes from the time of trade report input to TRACE to

review the trade and accept or decline to act as principal to the trade. If the clearing broker does not make an affirmative acceptance or declination of the trade report within 30 minutes, the trade report will be subject to normal TRACE processing and the clearing broker will be obligated to act as principal for the trade.]

6230. Transaction Reporting

(a) When and How Transactions are Reported

- (1) (A) [All NASD members] Members that are required to report transaction information pursuant to paragraph (b) below shall, within 1 hour after trade execution, transmit through TRACE during system hours, or if TRACE is unavailable due to system or transmission failure, by telephone to the TRACE Operations Center, reports of transactions in TRACE-eligible securities [Securities] executed between 8:00 a.m. and 6:30 p.m. Eastern Time [or shall utilize the Browse function in TRACE to accept or decline trades within 30 minutes after execution according to paragraph (b) of this rule]. Transactions not reported within 1 hour after execution shall be designated as late; provided, however, that if [unless] inadequate time remains prior to system close to allow a timely report[. In this situation], the member may report [must be made] the transaction the next day at system open as designated "as/of."
- (B) Members have an ongoing obligation to report transaction information promptly, accurately, and completely. The member may employ an agent for the purpose of submitting transaction information; however, the primary responsibility for the timely, accurate, and complete reporting of TRACE information remains the non-

delegable duty of the member obligated to report the transaction.

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

(A) Reports of transactions in TRACE-eligible securities [Securities] executed after 6:30 p.m. Eastern Time and before 12:00 a.m. Eastern Time shall be reported on the next day and be designated "as/of."[.] Such trade reports will not be included in daily market aggregates and will be disseminated beginning at 8:00 a.m. Eastern Time on the day of receipt.

(B) Reports of transactions in TRACE-eligible securities [Securities] executed after 12:00 a.m. Eastern Time and before 8:00 a.m. Eastern Time shall be reported that same day beginning at 8:00 a.m. Eastern Time[.] within the maximum time frame mandated. Such trade reports will be included in that day's market aggregates and disseminated upon receipt.

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

(b) Which Party Reports Transaction

[Both parties executing a transaction shall, subject to the input requirements below, either input trade reports into the TRACE system or utilize the Browse feature to accept or decline a trade within the applicable time frames as specified in paragraph (a)(1) of this Rule.] Trade data input obligations are as follows:

(1) [in] In transactions between two [TRACE Participants] members, the member representing the sell side shall submit a trade report to TRACE;

(2) [in] In transactions [between] involving a[n NASD] member and a non-member, including a customer, the [NASD] member shall submit a trade report to TRACE.

(c) Trade Information To Be Reported

Each TRACE trade report shall contain the following information:

- (1) CUSIP number or NASD symbol;
- (2) Number of bonds as required by paragraph (d) below;
- (3) Price of the transaction as required by paragraph (d) below;
- (4) A symbol indicating whether the transaction is a buy, sell or cross;
- (5) Date of Trade Execution (as/of trades only);
- (6) Contra-party's identifier;
- (7) Capacity - Principal or Agent (with riskless principal reported as principal) as required by paragraph (d) below;
- (8) Time of trade execution;
- (9) Reporting side executing broker as "give-up" (if any);
- (10) Contra side [introducing broker] Introducing Broker in case of "give-up" trade;
- (11) Stated commission;
- (12) Such trade modifiers as required by either: a) the TRACE [System] Rules; and/or b) the TRACE Users Guide[.]; and
- (13) Yield as required by SEC Rule 10b-10.

(d) Procedures for Reporting Price, Capacity, Volume

- (1) For agency and principal transactions, report the price, including the mark-up, mark-

down or commission (commission entered separately). Do not include accrued interest.

(2) For agency and principal transactions, report the actual number of bonds traded. Baby bonds (those with a face value of less than \$1,000) should be reported expressed as a decimal.

(3) For in-house [In house] cross transactions, report [should be reported] as follows:

Agency cross - report once as an agency trade; Principal cross - report twice, once as an individual principal buy and once as an individual principal sell.

(e) Transactions Not Required To Be Reported

The following types of transactions shall not be required to be reported:

- (1) Transactions [which] that are part of a primary distribution by an issuer;
- (2) Transactions made in reliance on Section 4(2) of the Securities Act of 1933;
- (3) Transactions in listed securities that are both executed on, and reported to, a national securities exchange;
- (4) Transactions where the buyer and the seller have agreed to trade at a price substantially unrelated to the current market for the TRACE-eligible security (e.g., to allow the seller to make a gift).

(f) Compliance With Reporting Obligations

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

Rule 6231. Reporting of Transaction Information Sent to Clearing Agency.

(a) When and How Transactions Are Reported

Each NASD member shall submit to TRACE the same transaction information (for transactions in TRACE-eligible securities) that the member supplies to its registered clearing agency for clearance and settlement. Such information shall be submitted to TRACE by the time the member transmits the information to its registered clearing agency.

(b) Reporting Parties

(1) In transactions between two members, both the member representing the sell side and the member representing the buy side shall submit the transaction information specified in paragraph (a) above to TRACE.

(2) In transactions involving a member and a non-member, including a customer, the member shall submit the transaction information specified in paragraph (a) above to TRACE.

[6240. TRACE Processing]

[Locked-in trades may be determined in the TRACE system by matching the trade information submitted by the reporting parties through one of the following methods:]

[(a) Trade by Trade Match]

[Both parties to the trade submit transaction data and the TRACE system performs an on-line match;]

[(b) Trade Acceptance]

[The TRACE reporting party enters its version of the trade into the system and the TRACE non-reporting contra party reviews the trade report and accepts or declines the trade. An acceptance results in a locked-in trade; a declined trade report is purged from the TRACE system at the end of trade date processing;]

[(c) Post Trade Date Processing]

[T+N entries may be submitted during system hours each business day. At the end of daily matching, all declined trade entries will be purged from the TRACE system. TRACE will not purge any open trade (i.e. unmatched or unaccepted) at the end of its entry day, but will carry-over such trades to the next business day for continued comparison and reconciliation.

TRACE will automatically lock in and submit to NSCC as such any carried-over T to T+21 (calendar day) trade if it remains open as of 2:30 p.m. on the next business day. TRACE will not automatically lock in T+22 (calendar day) or older open “as-of” trades that were carried-over from the previous business day; these will be purged by TRACE at the end of the carry-over day if they remain open. Members may re-submit these T+22 or older “as-of” trades as a comparison-only entry into TRACE on the next business day for continued comparison and reconciliation for up to one calendar year.]

[6250. TRACE Risk Management Functions]

[The TRACE system will provide the following risk management capabilities to clearing brokers:]

[(a) Trade File Scan]

[Clearing brokers will be able to scan the trading activities of their correspondent executing brokers through the TRACE system.]

[(b) Gross Dollar Threshold]

[Clearing brokers will be able to establish, on an inter-day or intra-day basis, gross dollar thresholds for purchases and sales for their correspondent executing brokers, and the

TRACE system will alert the clearing broker and its correspondent if the correspondent's trading activity equals or exceeds either threshold.]

[(c) Gross Dollar Threshold Pre-Alert]

[In addition to the gross dollar threshold alert, the TRACE system will also alert the clearing broker and its correspondent when the correspondent's trading activity equals or exceeds 70% of either gross dollar threshold.]

[(d) On-line Review]

[Clearing brokers that access TRACE through a computer interface will be able to receive intra-day activity of their correspondents as it is reported.]

[(e) Single Trade Limit]

[Clearing brokers will have 30 minutes from trade report input to TRACE to review any single trade executed by their correspondent executing brokers that equals or exceeds an amount set by the clearing broker for that correspondent in order to decide to act as principal. If, however, the clearing broker does not affirmatively accept or decline the trade, at the end of 30 minutes, the system will subject the trade to normal TRACE processing and the clearing broker will be obligated to act as principal to clear the trade.]

[(f) Super Cap]

[The Super Cap will be set at an amount to be determined by the Clearing Broker, but in no event less than the gross dollar threshold. When a correspondent's Super Cap is reached, notice will be furnished to TRACE participants, and no trade in excess of an amount set by

the clearing broker for that correspondent will be accepted for TRACE processing unless the clearing broker accepts the trade within 30 minutes of execution.]

[6260. Obligation to Honor Trades]

[If a TRACE Participant is reported by TRACE as a party to a trade that has been treated as locked-in and sent to NSCC, notwithstanding any other agreement to the contrary, that party shall be obligated to act as a principal to the trade and shall honor such trade on the scheduled settlement date.]

[6261. Compliance with TRACE Rules and Trade Reporting Requirements]

[Failure of an NASD member, or person associated with a member, to comply with any of the rules or requirements of TRACE, or failure of a member or associated person to comply with any of the transaction reporting requirements for TRACE-Eligible Securities may be considered conduct inconsistent with high standards of commercial honor and just and equitable principals of trade, in violation of Rule 2110.]

[6270] 6240. Audit Trail Requirements

The data elements specified in Rule [6220(c)] 6230(c) are critical to the Association's compilation of a transaction audit trail for regulatory purposes. As such, all member firms [utilizing] using the TRACE [Service] service have an ongoing obligation to input [6220(c)] Rule 6230(c) information accurately and completely.

[6280] 6250. Termination of TRACE Service

The Association may, upon notice, terminate TRACE service to a [Participant] member in the event that a[[n] TRACE Participant] member fails to abide by any of the rules or operating

procedures of the TRACE service or the Association, or fails to honor contractual agreements entered into with the Association or its subsidiaries, or fails to pay promptly for services rendered by the TRACE [Service] service.

[6290] 6260. Dissemination of Corporate Bond Trade Information

[Trade reports entered into TRACE will be collected, processed and disseminated on a real-time basis between 8:00 a.m. and 6:30 p.m. Eastern Time.]

(a) The Association will disseminate transaction information immediately upon receipt of transaction reports between 8:00 a.m. and 6:30 p.m. Eastern Time relating to transactions in Investment Grade corporate bonds having an initial issuance size of \$1 billion or greater.

(b) All trade reports in TRACE-eligible securities approved for dissemination and submitted to TRACE prior to 5:15 p.m. Eastern Time will be included in the calculation of market aggregates and last sale except 1)[.] trades reported on an “as of” basis, 2) “when issued” trades executed on a yield basis, or 3) trades in baby bonds with a par value of less than \$1,000.

[6291] 6270. Lead Underwriter Information Obligation

In order to facilitate trade reporting of secondary transactions in TRACE-eligible securities, the member that is the lead underwriter of any newly[-]issued TRACE-eligible security shall provide to the TRACE Operations Center the CUSIP number of any debt issue no later than on the effective date of the offering.

