

BY HAND

January 5, 2001

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-99-65, Amendment No. 4
Proposal to Require Reporting and Dissemination
of Fixed Income Transactions (TRACE)

Dear Ms. England:

Pursuant to Rule 19b-4, the National Association of Securities Dealers, Inc. ("NASD" or "Association") is filing this letter Amendment No. 4¹ to SR-NASD-99-65. The NASD is filing this Amendment No. 4 to make changes that are necessary to respond to the additional comments received after the publication of Amendment Nos. 2 and 3 and to clarify the existing proposal. The revised text of the proposed rules is set forth in attached Exhibit 1. We have enclosed a 3-1/2" disk containing Amendment No. 4 in Microsoft Word 7.0 to facilitate review and, if necessary, production of a Federal Register release.

I. **Rule Changes**

Rule 6210(a). *Changes to Definitions.* NASD is proposing changes to clarify the definition of "TRACE-eligible securities" in proposed Rule 6210(a). The proposed changes reorganize the definition and exclude specifically those securities that were excluded in explanatory text in the initial rule filing. 64 FR 69305, 69309 (Dec. 10, 1999). In addition, the Association has clarified that Investment and Non-Investment Grade securities that are issued pursuant to an exemption under Section 4(2) of the Securities Act of 1933, are purchased or sold pursuant to Rule 144A, and are depository eligible, are "TRACE-eligible securities" and are

¹ SR-NASD-99-65 was published in Securities Exchange Act Rel. No. 42201 (Dec. 3, 1999), 64 FR 69305 (Dec. 10, 1999); Amendment Nos. 2 and 3 were published in Securities Exchange Act Rel. No. 43616 (Nov. 24, 2000), 65 FR 71174 (Nov. 29, 2000). The NASD previously submitted Amendment No. 1 to reflect the Association's receipt of written comments from the Regional Municipal Operations Association (RMOA), but later withdrew the amendment after consultation with the Commission staff. NASD incorporated RMOA's comments and the NASD's response in Amendment No. 2.

generally subject to the Rule 6200 Series. Finally, the Association has clarified Rule 6210(d), “time of execution,” and made related minor changes to Rule 6230(a).

Rule 6220. *Technical Changes.* The NASD has made minor technical changes to Rule 6220(a)(2).

Rule 6230. *One Hour Reporting Period in Paragraph (a)(1).* Proposed Rule 6230(a)(1) currently provides that reporting will be required within one hour of the time of execution. The Association has received additional comments concerning the Association’s reference in the initial filing and Amendment No. 2 to the implementation of a 15 minute reporting period at some point in the future. If the NASD seeks to shorten the reporting period under proposed Rule 6230, the Association would be required to file a rule filing with the Commission, which would be subject to notice, comment, and the SEC’s approval. For this reason, it is not appropriate at this time for the NASD to respond to comments concerning possible future amendments to the one hour reporting period in proposed Rule 6230(a)(1).

Clarifications. Proposed Rule 6230(e) lists transactions that are not required to be reported. NASD is clarifying Rule 6230(e) by deleting clause (2). Clause (2) provided that transactions made in reliance on Section 4(2) of the Securities Act of 1933 would not be required to be reported. The intent of clause (2) was to clarify that transactions in fixed income securities issued under Section 4(2) of the Securities Act of 1933 that were not depository eligible (and, at the time of the transaction in question, remained subject to restriction in their sale or resale) would not be subject to reporting. Because the NASD has clarified the proposed definition of “TRACE-eligible security” in Rule 6210(a) relating to such unregistered securities, clause (2) is no longer necessary. The Association also has made technical corrections to Rule 6230(c).

Rule 6231. *Elimination of Duplicate Clearing Reports.* Proposed Rule 6231 requires that both sides to a trade submit to the NASD duplicate copies of the clearing reports submitted to their registered clearing agency (“duplicate clearing reports”). This proposal reflects the NASD’s need to have both sides to a trade reported to the NASD for regulatory purposes. Industry comments indicated that the transmission of duplicate clearing reports would be a more burdensome regulatory requirement than a provision to require both the buy- and sell- sides of the transaction to report the transaction to the NASD (“dual trade reporting”). As stated in Amendment No. 2 to the filing, the Association is interested in achieving the desired regulatory end through less burdensome means where possible. For that reason, the Association is amending the rule filing to eliminate the proposed duplicate clearing submission requirement (proposed Rule 6231) and is submitting separately for notice and comment a proposed rule change that will provide for dual trade reporting. See SR-NASD-01-04.

Rule 6240. *Elimination of Redundant Rule.* In response to comments, the Association is deleting proposed Rule 6240 because it is redundant of proposed Rules 6230(a)(1)(B) and (f).

Rule 6250. *FIPS 50 Securities Included in Rule 6250.* In the initial rule filing and Amendment No. 2, the NASD stated that transactions in “FIPS 50” fixed income securities² would become subject to dissemination at the time reporting in such securities began under the proposed Rule 6200 Series.³ The NASD wishes to correct and clarify proposed Rule 6250(a) as set forth in attached Exhibit 1 explicitly to include the reference to the FIPS 50 securities.⁴

Additional Clarification of Rule 6250. In response to comments, the NASD is clarifying that the Investment Grade bonds for which we will disseminate trade reports under proposed Rule 6250 must be rated Investment Grade at the time that the NASD receives the trade report. In addition, the NASD is making explicit in Rule 6250(a) that market aggregate and last sale information will be collected, updated, and disseminated on a continuing basis only through 5:15 p.m., even though the Association will continue to collect and disseminate information on individual transactions on a continuing basis through 6:30 p.m. We also are moving to Rule 6250 certain provisions currently found in proposed Rule 6230 relating to the dissemination of after-hours trade reports. Finally, the NASD is making clarifying changes to proposed Rule 6250(b)(4). The effect of these changes will be to exclude the price of certain non-standard transactions in a fixed income security from the calculation of the market aggregate figures or the last sale figures for such security.

II. Other Changes

SIP Status. The NASD is no longer proposing that the Association register voluntarily as a “securities information processor” (“SIP”) acting in an exclusive or non-exclusive capacity, or otherwise be registered or subject to registration as an “exclusive processor” (“EP”). The NASD, as a registered securities association that is engaged in collecting, processing, and distributing transaction information in fixed income securities, will be subject to the Commission’s full oversight and review. This includes the authority to ensure that any fees the NASD eventually proposes are fair and reasonable.

In this connection, the Association notes that the proposed rules continue not to specify or in any way limit the means by which members may report trades to the NASD, and thus allow members to submit required trade reports directly to the NASD over Computer To Computer Interface or the Internet, or indirectly through vendors or other entities, who in turn have links into the NASD. See specifically proposed Rule 6230(a)(1)(B). In other words, contrary to the assertions of some commenters, the NASD does not propose, and in fact has never proposed, any

² “FIPS 50” securities are 50 high yield “FIPS securities,” designated under the NASD’s current Rule 6210(f) and Rule 6220, relating to the Fixed Income Pricing System.

³ Securities Exchange Act Rel. No. 42201(Dec. 3, 1999), 64 FR 69305, 69309-69310 (Dec. 10, 1999); Securities Exchange Act Rel. No. 43616 (Nov. 24, 2000); 65 FR 71174, 71179-71180 (Nov. 29, 2000).

⁴ Also, the NASD wishes to clarify that the reference to “investment grade” in the dissemination discussion in Amendment No. 2 at 65 FR 71174, 71180 under the caption “Phase I,” should be corrected to read, “Investment Grade,” the term defined in proposed Rule 6210(h).

sort of “monopoly” over bond transaction data collection. In addition, the NASD will not sell unconsolidated data at all and will not compete in the market for the resale of consolidated data.

Implementation Schedule. The NASD is proposing a minor amendment to the implementation schedule set forth in Amendment No. 2. In Amendment No. 2, the NASD proposed to seek SEC approval to begin Phase I of TRACE 180 days following SEC approval of the service. The proposal was made to allow NASD members to better prepare for the advent of TRACE trade reporting as well as to give the NASD sufficient time to more fully test TRACE technology. The NASD’s intent was to provide its members a full 180 days to so prepare. The NASD is concerned that it would be unfair to members to start the 180 period from the date of Commission approval, if the Commission approves the rule filing in the near future and the NASD is not fully prepared to deliver the technical specifications relating to TRACE to its members. Thus, to provide the industry the full 180 day period to prepare for TRACE, the NASD proposes that TRACE shall become effective 180 days after the date that the NASD provides technical specifications relating to TRACE to members to allow them to make the system changes necessary to comply with TRACE. The NASD will announce the implementation date of the proposed rule change in an announcement to members.

In this connection, the Association also notes that the NASD will not implement TRACE until the NASD has received Commission approval of a fee schedule that has been subject to the notice and comment process. The fee schedule will provide for full and fair recovery by the NASD of the historical and ongoing development costs and operating costs of TRACE and its associated regulatory systems and procedures.⁵

III. Statutory Basis

The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Securities Exchange Act of 1934 (“Exchange Act”), which requires, among other things, that the Association’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. The NASD’s proposed rule change, if approved, will establish rules for the reporting and dissemination of information on eligible fixed income transactions that will provide the NASD, as the self-regulatory organization designated to regulate the over-the counter markets, with heightened capabilities to regulate the fixed income markets in order to prevent fraudulent and manipulative acts and practices. The proposed structure to collect the information, with the NASD acting as the proposed consolidator of such information is consistent with the requirements of the Exchange Act and will foster cooperation and coordination with persons engaging in regulating, clearing, settling, and processing of information with respect to fixed income securities and among persons facilitating transactions in fixed income securities. The proposed rule change, by requiring reporting and dissemination

⁵ See Securities Exchange Act Rel. No. 42208 (Dec 3, 1999), at 24 (indicating support for recovery of certain regulatory costs via market data fees).

of such transaction information, will protect investors and the public interest by, among other things, increasing transparency in the fixed income markets.

The NASD believes that the amended proposal imposes no burden on competition not necessary and appropriate in furtherance of the purposes of the Act. Specifically, the amended proposal allows for competition in the collection of trade reports, and limits the NASD's role to: (1) collecting trade reports directly only from members that choose to report directly to the NASD; (2) consolidating trade reports for regulatory purposes and (3) disseminating the consolidated data to broker-dealers and those interested in reselling the data but not competing in the market for resale of these data. Any fees the NASD seeks to impose for performing these functions will be subject to SEC review and approval under the standards set forth for these purposes under Sections 11A and 15A of the Exchange Act. In this connection, the NASD intends to withdraw completely from the real-time dissemination function, and to limit its role to receiving bond trading data for regulatory use only, as soon as a practicable market-driven system for processing and disseminating a reliable and uniform consolidated stream of bond trading data can be developed. Until such a system is developed and ready to implement, the NASD believes that its proposal represents in fact the least anti-competitive approach to producing in the near-term consolidated bond data that is sufficiently reliable for public dissemination.⁶

The NASD requests that the Commission find good cause pursuant to Section 19(b)(2) for approving proposed Amendment No. 4 prior to the 30th day after publication in the Federal Register. First, the proposed changes in Rule 6210(a) that were made to reorganize the definition of "TRACE-eligible security" only clarify the concepts previously published as part of the initial filing. Second, the changes to Rule 6250 regarding the dissemination of the FIPS 50 securities also are clarifying or technical changes only and have been previously subject to notice and comment during both comment periods. Third, proposed Rule 6231 has been subject to notice and comment and is being eliminated in response to concerns raised by commenters. Fourth, the NASD's proposed implementation schedule change provides additional time for the industry to prepare for TRACE and is a change that is consistent with the intent of the 180 day period as proposed in Amendment No. 2 and published for comment. Fifth, the Commission may find good cause to approve the NASD's decision regarding SIP status on an accelerated basis because the proposed change will work no substantive change on the proposed TRACE project or on the Commission's oversight of the NASD in its role as the TRACE information processor. Finally, the other proposed changes to the proposed rules are purely technical, in that they clarify existing rule language, correct minor errors, delete redundancies, or reorganize existing rule language; such changes may be approved on an accelerated basis.

⁶ As at least one commenter points out, the statute does not require that our proposal reflect the least anti-competitive approach, but rather impose no burden on competition not necessary or appropriate in furtherance of the purposes of the Act. See letter from Bloomberg L.P. to Jonathan Katz, dated December 22, 2000, at p. 4. Nonetheless we believe, for the reasons stated above, that our proposal not only satisfies the statutory test but also in fact represents under current circumstances the least anti-competitive approach to achieving reliable consolidated corporate bond transaction information dissemination.

Katherine A. England

January 5, 2001

Page 6

If you have any question concerning Amendment No. 4, please call Sharon Zackula, Office of General Counsel, NASD Regulation at 202-728-8985; email- sharon.zackula@nasd.com.

Sincerely,

Alden S. Adkins
Senior Vice President
and General Counsel

Exhibit

Katherine A. England
January 5, 2001
Page 7

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Exhibit 1
Proposed Rule Language
SR-NASD-99-65, Amendment No. 4

Proposed additions are underlined; proposed deletions are in brackets

6210. Definitions

The terms used in this 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" 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).]

The term "TRACE-eligible security" shall mean all United States dollar denominated debt securities that are depository eligible securities under Rule 11310(d); Investment Grade or Non-Investment Grade; issued by United States and/or foreign private corporations; and: (1) registered with the Securities and Exchange Commission; or (2) issued pursuant to Section 4(2) of the Securities Act of 1933 and purchased or sold pursuant to Rule 144A. The term "TRACE-eligible security" excludes mortgage- or asset-backed securities, collateralized mortgage obligations, and money market instruments.

(b) and (c) No change.

(d) The term “time of execution” for a transaction in a TRACE-eligible security shall be the time when the parties to the transaction agree to all of the terms of the transaction 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 to the transaction.

(e) through (i) No change.

6220. Participation in TRACE

(a) Mandatory Member Participation

(1) No change

(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 [A]application [A]agreement and all applicable rules and operating procedures of the Association and the Commission; and

(B) No Change.

* * *

6230. Transaction Reporting

(a) When and How Transactions are Reported

(1)(A) Members that are required to report transaction information pursuant to paragraph (b) below shall, within one hour [after trade execution] of the time of 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 executed between 8:00 a.m. and 6:30 p.m. Eastern Time. Transactions not reported within 1 hour after [execution] the time of execution shall be designated as late; provided, however, that if inadequate time remains prior to system close to allow a timely report, the member may report 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] transaction 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 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

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.]

(b) No change.

(c) Transaction Information To Be Reported

(1) through (11) No change.

(12) Such trade modifiers as required by either [: a)]the TRACE [R]rules[; and/or b)] or the TRACE [U]users [G]guide; and

(13) No change.

(d) No change.

(e) Transactions Not Required to Be Reported

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

(1) Transactions 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)] (2) Transactions in listed securities that are both executed on, and reported to, a national securities exchange; and

[(4)] (3) 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) No change.

[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. Audit Trail Requirements]

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

[6250.] 6240. Termination of TRACE Service

The Association may, upon notice, terminate TRACE service to a member in the event that a 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.

[6260.]6250. Dissemination of Corporate Bond Trade Information

(a) Immediately upon receipt of transaction reports between 8:00 a.m. and 6:30 p.m. Eastern Time, the[The] Association will disseminate transaction information [immediately upon receipt of transaction reports between 8:00 a.m. and 6:30 p.m. Eastern Time] (except that market aggregate information and last sale information will not be updated after 5:15 p.m.) relating to transactions in:

(1) a TRACE-eligible security [Investment Grade corporate bonds] having an initial issuance size of \$1 billion or greater that is Investment Grade at the time of receipt of the transaction report[.]; and

(2) a security that is denominated as a “Fixed Income Pricing System (FIPS)” security under NASD Rules relating to FIPS securities immediately prior to the time that such rules are rescinded.

(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, or[.]

(4) trades in which the price is determined by a weighted average.

(c) Reports of transactions in TRACE- eligible securities executed after 6:30 p.m. Eastern Time and before 12:00 a.m. Eastern Time that are reported pursuant to Rule 6230(a)(2)(A) on the next day and designated “as/of” 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.

(d) Reports of transactions in TRACE-eligible securities executed after 12:00 a.m. Eastern Time and before 8:00 a.m. Eastern Time and reported that same day beginning at 8:00 a.m. Eastern Time pursuant to Rule 6230(a)(2)(B) will be included in that day’s market aggregates and disseminated upon receipt.

[6270.] 6260. 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.

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