

rule change be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47302; File No. SR-NASD-2002-174]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by National Association of Securities Dealers, Inc., Relating to Increasing Dissemination of Debt Securities Transaction Information Under the TRACE Rules

January 31, 2003.

#### I. Introduction

On December 6, 2002, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change 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> to amend the Rule 6200 Series of the Rules of NASD, which provides for the reporting and dissemination of transaction information in eligible corporate debt securities ("TRACE Rules"). The proposed rule change would provide additional transparency in the corporate bond market by increasing the categories of TRACE-eligible securities for which transaction information is required to be disseminated. NASD amended the proposed rule change on December 18, 2002.<sup>3</sup> Notice of the proposed rule change and Amendment No. 1 thereto was published for comment in the **Federal Register** on December 27, 2002.<sup>4</sup> The Commission received two

comment letters regarding the proposal.<sup>5</sup>

This order approves the proposed rule change as amended by Amendment No. 1.

#### II. Background

On January 23, 2001, the Commission approved the TRACE Rules to establish a corporate bond trade reporting and transaction dissemination facility and to eliminate Nasdaq's Fixed Income Pricing System ("FIPS").<sup>6</sup> Subsequently, on March 5, 2001, the Commission approved amendments to the TRACE Rules requiring trade reports in transactions between two NASD members to be filed by each member.<sup>7</sup> In addition, on January 3, 2002, the Commission issued a notice stating that certain other amendments to the TRACE Rules had become effective on filing.<sup>8</sup> On June 28, 2002, the Commission approved a proposed rule change to establish fees for the use of TRACE on a pilot basis for six months,<sup>9</sup> and also approved proposed amendments to the TRACE Rules to make technical changes to the TRACE Rules and clarify certain provisions of those Rules prior to implementation of TRACE.<sup>10</sup>

The TRACE Rules became effective on July 1, 2002. On that day, members began to report transactions in TRACE-eligible securities, and the TRACE system began the dissemination of certain reported information. On November 22, 2002, the Commission issued a notice stating that NASD was reducing certain TRACE fees for the fourth quarter of 2002.<sup>11</sup> On December 19, 2002, the Commission issued a notice stating that an extension of the

<sup>5</sup> See letter from John M. Ramsay, Vice President and Senior Regulatory Counsel, The Bond Market Association ("TBMA"), to Jonathan G. Katz, Secretary, SEC, dated January 16, 2003 ("TBMA's Letter") and letter from Rene L. Robert, President and CEO, Advantage Data, Inc., to Secretary, SEC, dated January 10, 2003 ("Advantage Data's Letter"). TBMA's Letter and Advantage Data's Letter are described in Section IV, *infra*.

<sup>6</sup> See Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131 (January 29, 2001) (File No. SR-NASD-1999-65). FIPS, which was operated by Nasdaq, collected transaction and quotation information on domestic, registered, non-convertible high-yield corporate bonds.

<sup>7</sup> See Securities Exchange Act Release No. 44039 (March 5, 2001), 66 FR 14234 (March 9, 2001) (File No. SR-NASD-2001-04).

<sup>8</sup> See Securities Exchange Act Release No. 45229 (January 3, 2002), 67 FR 1255 (January 9, 2002) (File No. SR-NASD-2001-91).

<sup>9</sup> See Securities Exchange Act Release No. 46145 (June 28, 2002), 67 FR 44911 (July 5, 2002) (File No. SR-NASD-2002-63).

<sup>10</sup> See Securities Exchange Act Release No. 46144 (June 28, 2002), 67 FR 44907 (July 5, 2002) (File No. SR-NASD-2002-46).

<sup>11</sup> See Securities Exchange Act Release No. 46893 (November 22, 2002), 67 FR 72008 (December 3, 2002) (SR-NASD-2002-167).

pilot program for TRACE fees to February 28, 2002 and a modification of the pilot effective January 1, 2003 had become effective on filing.<sup>12</sup>

#### III. Description of the Proposal

NASD is proposing to amend: (1) NASD Rule 6250 to provide for the dissemination of transaction information on additional Investment Grade TRACE-eligible securities under the NASD Rule 6200 Series (also known as the Trade Reporting and Compliance Engine ("TRACE") Rules);<sup>13</sup> (2) NASD Rule 6210(e) to include the term "customer" in the defined term, "party to the transaction"; (3) NASD Rule 6260 to make minor clarifications; and, (4) in the provisions referenced in (1) through (3) above, to delete the term "Association" and to replace it with "NASD." These amendments are discussed in greater detail in the Commission's notice soliciting public comment on this proposal.<sup>14</sup>

In Amendment No. 1, NASD deleted proposed changes to NASD Rule 6230 and NASD Rule 9610(a) that would have allowed members to request exemptive relief from NASD Rule 6230.

#### IV. Discussion

After careful consideration, the Commission finds that the proposed rule change, as amended by Amendment No. 1, is consistent with the Act and the rules and regulations promulgated thereunder applicable to a registered securities association and, in particular, with the requirements of Section 15A(b)(6).<sup>15</sup> Specifically, the Commission finds that approval of the proposed rule change is consistent with Section 15A(b)(6) of the Act in that it is 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.<sup>16</sup>

The Commission believes that the proposed rule change will substantially increase the amount of information available to the public and market participants about the corporate debt markets and will clarify other TRACE Rule provisions. NASD stated that if the proposed rule change is approved, over 4,000 TRACE-eligible securities will be

<sup>12</sup> See Securities Exchange Act Release No. 47056 (December 19, 2002), 67 FR 79205 (December 27, 2002) (File No. SR-NASD-2002-176).

<sup>13</sup> The terms "Investment Grade" and "TRACE-eligible security" are defined in TRACE Rule 6210. Definitions, in paragraphs (h) and (a), respectively.

<sup>14</sup> See *supra*, note 4.

<sup>15</sup> 15 U.S.C. 78o-3(b)(6).

<sup>16</sup> In approving this proposed rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>12</sup> 17 CFR 200.30-3(a)(12).

<sup>13</sup> 15 U.S.C. 78s(b)(1).

<sup>14</sup> 17 CFR 240.19b-4.

<sup>15</sup> See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katharine A. England, Assistant Director, Division of Market Regulation, SEC, dated December 18, 2002, and enclosures ("Amendment No. 1"). In Amendment No. 1, NASD deleted proposed changes to NASD Rule 6230 and NASD Rule 9610(a) that would have allowed members to request exemptive relief from NASD Rule 6230.

<sup>16</sup> See Securities Exchange Act Release No. 47057 (December 19, 2002), 67 FR 79210.

subject to dissemination under NASD Rule 6250, which represents approximately 75% of the current average daily trading volume of Investment Grade TRACE-eligible securities.<sup>17</sup> The proposed rule change substantially exceeds the anticipated increase in dissemination in the second phase of TRACE, "Phase II," described in the original regulatory scheme approved by the SEC.<sup>18</sup> In addition, the proposed amendments are crafted to disseminate transactions in a diverse test group of 90 of the lowest rated Investment Grade TRACE-eligible debt securities to obtain additional empirical data about the impact that dissemination may have on the liquidity of a market or a market sector.

In NASD Rule 6210(e), NASD is proposing to add the term, "customer," to the defined term, "party to the transaction." Under the TRACE Rules, a non-NASD-member customer of a broker-dealer, when buying or selling a security, is considered a "party to the transaction." In addition, for purposes of the Rule, "customer" includes a broker-dealer that is not an NASD member.<sup>19</sup> NASD believes, and the Commission agrees, that NASD Rule 6210(e) would be clearer if the term "customer" is included in the definition of "party to the transaction," and the Rule clearly states that broker-dealers that are not NASD members are included in the term "customer."

As previously noted, the Commission received two comment letters, from TBMA and Advantage Data, on the proposed rule change.<sup>20</sup> Although TBMA generally supported the latest amendments, it proposed one change. TBMA noted that as the proposal was

originally filed by NASD with the Commission, it provided that NASD could exempt a member from particular provisions of the TRACE rules for good cause shown, pursuant to NASD's Rule 9600 Series. NASD later amended the proposal to delete this provision. TBMA requested that the exemptive provision be reinstated. After considering TBMA's Letter, the Commission believes that the absence of exemptive authority with respect to TRACE reporting does not make these rules inconsistent with the statute.

Advantage Data's Letter raised a number of specific concerns, including concerns about NASD's mandated use of CUSIP data in TRACE reporting, the ongoing review of NASD's handling of TRACE reporting, the implementation of a permanent fee structure for TRACE, certain delays in disseminating TRACE information and the ownership of derived data. Advantage Data states that vendors and investors should be able to receive TRACE information without having to receive CUSIP data licensed by Standard & Poor's Corporation, and that Advantage Data would like to be allowed to receive TRACE information without receiving CUSIP data via a redistribution vendor. However, the proposal does not appear to prohibit redistribution vendors from removing CUSIP data from the BTDS (TRACE) data feed and providing TRACE data to users and other vendors without the requirement to have a CUSIP subscription.

Advantage Data's Letter also contends that the proposed BTDS Vendor Agreement currently requires a four-hour delay for disseminating delayed TRACE information and that the NASD claims ownership of the TRACE information and "any derivation thereof" in the proposed Vendor Agreement. These concerns relate to the vendor agreements rather than to the TRACE Rules. The TRACE vendor agreements were not included as part of this filing. Therefore, the Commission is not approving or disapproving the vendor agreements.

The Commission does consider concerns raised in comments about the vendor agreements in determining whether the proposed rules will operate in a manner consistent with the statute. The Commission does not believe that the impact of the vendor agreement provisions challenged by Advantage Data on the operation of the rules is sufficient to make the proposed rules inconsistent with the statute. The CUSIP license requirement is a relatively narrow limitation on receipt of the

data.<sup>21</sup> The dissemination delay and ownership assertions are ancillary to the TRACE service proposed in the filing, with little collateral effect on its operation.

Advantage Data's Letter further states that it does not believe that the TRACE fee structure should be made permanent because it expects that the fees collected by NASD will dramatically increase in the years to come. This proposal does not address the TRACE permanent fee structure. Finally, Advantage Data's Letter raised questions about NASD's ongoing handling of TRACE. The Commission expects to continue its review of NASD's operation of TRACE in the context of future proposed rule filings filed by NASD as well as the Commission's ongoing oversight of NASD as a self-regulatory organization.

## V. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act and the rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NASD-2002-174), as amended, be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>22</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47300; File No. SR-NASD-2003-10]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. To Eliminate SuperMontage Fees for Cancellation and Cancel/Replace of Quotes/Orders

January 31, 2003.

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 January 30, 2003, the National Association of Securities Dealers, Inc. ("NASD"),

<sup>21</sup> Of course, if the vendor agreements are viewed by commenters as creating an unreasonable denial of access to TRACE services, that claim can be raised in a review process under Section 19(d) of the Act. 15 U.S.C. 78s(d).

<sup>22</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>17</sup> Trading volume is the total par value of all Investment Grade TRACE-eligible securities traded (and reported) each day.

<sup>18</sup> See Securities Exchange Act Release No. 43873 (January 23, 2001); 66 FR 8131 (January 29, 2001) ("Approval Order"). In the Approval Order, the SEC approved NASD Rule 6250, which provided that initially, transaction information on publicly offered, Investment Grade bonds with an initial issuance size of \$1 billion or greater, and the FIPS 50, would be distributed immediately. The SEC also discussed NASD's plans to phase in the dissemination of additional securities. Under the phase-in schedule, the Bond Transaction Reporting Committee ("BTRC"), an advisory committee of industry representatives, was to advise the NASD Board of Governors regarding liquidity issues. By the end of Phase I, the BTRC was obligated to recommend to the NASD Board "dissemination protocols for investment grade bonds, starting with the largest issuance size, that, when combined together, make up the top 50% (by dollar volume) of such bonds." 66 FR 8131, 8134. Dissemination of these securities was to begin in Phase II. File No. SR-NASD-99-65.

<sup>19</sup> NASD Rule 0120(g) provides generally that the term "customer" shall not include a broker or dealer.

<sup>20</sup> See *supra*, note 5.