

Amendment Nos. 2 and 3 to the proposed rule change.

## VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 2 and 3, including whether Amendment Nos. 2 and 3 are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-2002-46 and should be submitted by July 26, 2002.

## VII. 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-2002-46), as amended, be and hereby is approved, and that Amendment Nos. 2 and 3 thereto are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

**J. Lynn Taylor,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46145; File No. SR-NASD-2002-63]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment Nos. 1 and 2 Thereto, and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 3 Thereto, by the National Association of Securities Dealers, Inc., Relating to Proposed Fees for the Trade Reporting and Compliance Engine (TRACE) for Corporate Bonds

June 28, 2002.

## I. Introduction

On May 6, 2002, the National Association of Securities Dealers, Inc. ("NASD" or "Association") 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 establish fees for use of TRACE. TRACE provides for the reporting and dissemination of transaction information in eligible corporate debt securities. The NASD submitted Amendment No. 1 to the proposed rule change on May 16, 2002.<sup>3</sup> Notice of the proposed rule change was published for comment in the **Federal Register** on May 24, 2002.<sup>4</sup> The NASD submitted Amendment No. 2 to the proposed rule change on May 28, 2002.<sup>5</sup> The Commission received one comment letter, from The Bond Market Association ("TBMA"), regarding the proposal.<sup>6</sup>

On June 25, 2002, the NASD filed Amendment No. 3 to the proposed rule change and a response to TBMA's Letter. This order approves the proposed rule change, as amended by Amendment Nos. 1 and 2, accelerates approval of Amendment No. 3, and

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

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

<sup>3</sup> See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), dated May 16, 2002. Amendment No. 1 corrected a typographical error in the filing.

<sup>4</sup> See Securities Exchange Act Release No. 45960 (May 17, 2002), 67 FR 36654.

<sup>5</sup> See letter from T. Grant Callery, Senior Vice President and General Counsel, NASD, to Katherine England, Assistant Director, Division, dated May 24, 2002. Amendment No. 2 made the language of the rule internally consistent and corrected certain typographical errors.

<sup>6</sup> See letter from Michel de Konkoly Thege, Vice President and Associate General Counsel, TBMA, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated June 14, 2002 ("TBMA's Letter"). TBMA's Letter is described in Section IV, *infra*.

solicits comments from interested persons on Amendment No. 3.

## II. Background

On January 23, 2001, the Commission approved the Rule 6200 Series providing for reporting and dissemination of transaction information in eligible debt securities ("TRACE rules").<sup>7</sup> Subsequently, on March 5, 2001, the Commission approved additional amendments to the TRACE rules requiring trade reports in transactions between two NASD members to be filed by each member.<sup>8</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>9</sup> Finally, on April 3, 2002, the NASD filed a proposed rule change to make certain technical changes to the TRACE rules. The NASD subsequently submitted Amendment No. 1 to that filing, and the Commission published notice of the proposal and Amendment No. 1 thereto.<sup>10</sup> The NASD subsequently submitted Amendment Nos. 2 and 3 to that filing. The Commission is approving that filing, and granting accelerated approval of Amendment Nos. 2 and 3, concurrently with approval of this proposal.<sup>11</sup>

The TRACE rules will become effective on July 1, 2002. On that day, members must begin to report transactions in TRACE-eligible securities, and the TRACE system will begin the dissemination of certain reported information.

## III. Description of the Proposal

The proposed rule change establishes fees for participants and users of the TRACE facility and rescinds the FIPS fees. The proposed fees are divided into three general categories: (1) System fees paid by member firms based on the method chosen by the member to report corporate bond transactions to the NASD (members will have several options on how to report trades and the fees will vary accordingly); (2) transaction reporting fees paid by members to file trade reports and cancel or correct trade reports; and (3) market data fees paid by members and non-

<sup>7</sup> See Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131 (January 29, 2001) (File No. SR-NASD-1999-65).

<sup>8</sup> See Securities Exchange Act Release No. 44039 (March 5, 2001), 66 FR 14234 (March 9, 2001) (File No. SR-NASD-2001-04).

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

<sup>10</sup> See Securities Exchange Act Release No. 45943 (May 16, 2002), 67 FR 36049 (May 22, 2002).

<sup>11</sup> See Securities Exchange Act Release No. 46144, (June 28, 2002).

<sup>18</sup> 17 CFR 200.30-3(a)(12).

members that use or distribute the data collected through the TRACE system and disseminated by the NASD.

**System Fees.** The NASD proposes to charge fees to members who use the TRACE system based on the method the member selects to input transaction information to the NASD. Under the proposed rules, members will have three means by which to input transaction information directly to the NASD: (1) A web browser through the Internet, which will be useful primarily for low-volume firms; (2) a web browser using a private data network ("PDN"); or (3) a computer-to-computer interface ("CTCI"), which the Association anticipates will be used primarily by high volume firms. Members may also choose to report transactions indirectly to the NASD through third parties, such as vendors, service bureaus, clearing firms, or the National Securities Clearing Corporation ("NSCC"), which will in turn report to the NASD through one of the approved methods described above.

Members may report transaction information manually through a web browser using their own Internet provider. Members using a web browser will be charged a monthly access fee as follows: for the first user ID registered, a charge of \$85 per month; for the next two through nine user IDs registered, a charge of \$75 per month, per such additional user ID; and for ten or more user IDs registered, a charge of \$70 per month, per user ID from two to ten or more. Members reporting through a web browser may elect to report transaction information through a PDN that is owned and operated by Nasdaq's designated network provider, which is currently WorldCom, Inc. Members choosing to report transaction information directly to the NASD using a PDN will be charged a \$100 per line administration fee per month by the NASD. Members should be aware that this fee does not include fees that will be charged by Nasdaq for services provided by its designated network provider that will be billed directly by Nasdaq.

Members also may report transaction data through the CTCI operated by Nasdaq for most of its transaction reporting facilities. Nasdaq currently leases dedicated lines from WorldCom, Inc. and provides direct connection from a member firm to the NASD. The NASD monthly charge for reporting through a CTCI is \$25 per month, per line, whether or not such line is used exclusively for TRACE, and does not include Nasdaq charges for its designated network provider.

**Transaction Reporting Fees.** Members will be charged fees to file transaction reports and cancel or correct transaction reports. The NASD proposes to charge a trade reporting fee using a sliding scale, based upon the size of the transaction reported. A member will be charged a Trade Reporting Fee on a sliding scale ranging from \$0.50 to \$2.50 per trade based on the size of the reported transaction. For trades up to and including \$200,000 par value, members will be charged a fee of \$0.50 per trade; for trades between \$201,000 par value and \$999,000 par value, members will be charged a fee of \$0.0025 multiplied by the number of bonds traded; and for trades of \$1,000,000 par value or more, members will be charged a fee of \$2.50 per trade.

The NASD proposes to charge a cancel or correct trade fee of \$3.00 per trade. The NASD also proposes to charge an "as/of" trade late fee of \$3.00 per trade. Under proposed rule 6230(a)(2), SR-NASD-2002-46, a transaction that is executed after 6:30 p.m. must be reported within the first 1 hour and 15 minutes after the open of the market on the following business day to be reported on time "as/of."<sup>12</sup> A member shall be charged an "as/of" trade late fee of \$3.00 per transaction for those transactions reported beyond such time frame. To provide firms time to adjust to the new reporting system, the cancel or correct trade fee and "as/of" trade late fee will not be charged until the later of October 1, 2002 or 90 days after the effective date of TRACE. In addition, NASD proposes a browse and query fee of \$0.05 for each returned page of query beyond the first page. This feature will allow members to review their own previously reported data.

In order to standardize corporate bond reporting obligations and minimize industry technology burdens, NASD has proposed (as part of the TRACE filing with the Commission) the elimination of the separate FIPS system and its related rules and costs. The TRACE trade reporting fee will replace the flat fee of \$1.00 per trade currently charged to report corporate bonds through FIPS.

**Market Data Fees.** The NASD proposes to charge market professionals who subscribe to receive real-time market data as follows: (i) Bond Trade Dissemination Service ("BTDS") Professional Display Fee of \$60 per month per terminal for each interrogation or display device receiving

real-time TRACE transaction data; (ii) BTDS Internal Usage Authorization Fee of \$500 per month per organization for internal dissemination of real-time TRACE transaction data used in one or more of the following ways: internal operational and processing systems, internal monitoring and surveillance systems, internal price validation, internal portfolio valuation services, internal analytical programs leading to purchase/sale or other trading decisions, and other related activities;<sup>13</sup> (iii) BTDS External Usage Authorization Fee of \$1,000 per month per organization for dissemination of real-time TRACE transaction data used in one or more of the following ways: repackaging of market data for delivery and dissemination outside the organization, such as indices or other derivative products.<sup>14</sup> Non-professionals that subscribe to receive real-time TRACE transaction data will be charged \$1.00 per month, per terminal. In addition, the NASD proposes a fee of \$15.00 per month, per subscriber for the daily list fax service that will contain all of the daily additions, deletions, modifications to the list of TRACE-eligible securities.

Market participants and others who wish to receive real-time TRACE data directly from the NASD will be required to enter into agreements with the NASD. For example, a vendor or broker/dealer firm that wishes to distribute TRACE real-time data externally will be required to enter into a vendor agreement, which among other things will standardize display facilities and require the vendor to collect specified dissemination fees from its end users for remittance to the NASD. Vendors or broker/dealer firms that wish to receive real-time TRACE data directly from the NASD and subsequently disseminate real-time TRACE data only internally will also be required to execute agreements with the NASD, which among other things, will require firms to represent that the TRACE real-time data will not be disseminated externally.

#### IV. Discussion

After careful consideration, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a registered securities

<sup>13</sup> Under this service, real-time TRACE transaction data may not be used in any interrogation display devices, any systems that permit end users to determine individual transaction pricing in real-time, or disseminated to any external source.

<sup>14</sup> Under this service, real-time TRACE transaction data may not be used in any interrogation display devices or any systems that permit end users to determine individual transaction pricing in real-time.

<sup>12</sup> The NASD has proposed generally to amend the reporting period from 1 hour to 1 hour and 15 minutes, and this period would apply to transactions executed after 6:30 p.m. and reported the next morning. That proposal is being approved concurrently with this proposal.

association. In particular, the Commission believes that the proposed rule change is consistent with the requirement of section 15A(b)(5)<sup>15</sup> that the rules of an association provide for the equitable allocation of reasonable fees, dues, and other charges among its members and issuers and other persons using its facilities; and the requirement of section 15A(b)(6)<sup>16</sup> that the rules of the association are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.<sup>17</sup> The Commission believes that the fees allow users great flexibility in how they will interact with the system, and are scaled according to objective criteria applied across-the-board to all categories of users.

#### *1. Equitable Allocation and Unfair Discrimination*

The Commission believes that the proposal provides for the equitable allocation of reasonable fees, dues, and other charges, and does not permit unfair discrimination between customers, issuers, brokers, or dealers. For example, in several instances, the TRACE fee structure adopts a sliding scale approach. The Commission believes that this sliding scale structure promotes an equitable distribution of the relevant fees while reducing the possibility of unfair discrimination between customers, issuers, brokers, or dealers.<sup>18</sup> For example, transaction reporting fees vary depending on the size of the transaction reported by the member, with fees ranging from \$0.50 per trade (for the smallest trades) to \$2.50 per trade (for the largest trades). Similarly, system fees for members who report to TRACE through a web browser are scaled so that the amount of the fee decreases in proportion to the number of user identification members registered to the member. This permits members to take advantage of economies of scale.

In other instances, the TRACE fees vary according to the way in which the user intends to use the disseminated TRACE data. For example, market data fees are lower for users who limit their use of the information to internal distribution, and relatively higher for

users who repackage the data for delivery outside of the organization. The Commission believes that this use-based approach is consistent with equitable distribution of fees.

#### *2. Reasonableness*

The Commission believes that the TRACE fee structure is reasonable under the Act. In its initial filing, the NASD represented that it believes the TRACE fees are reasonably related to the costs of developing the new facility and to meeting the estimated operating expenses of the TRACE system. Specifically, the NASD represented that developmental costs of TRACE, to date, were roughly \$7.2 million. In addition, the NASD represented that total operating costs for TRACE are estimated to be approximately \$6 million annually. The NASD represented that the proposed fees are intended to help the NASD recover the developmental costs of the new system, fund ongoing operational costs, and fund the regulatory activities necessary for surveillance of the market, with a view towards making TRACE financially self-sustaining. The NASD also represented that the various levels of market data fees are intended to provide market participants with the flexibility to select the usage level that best meets their needs. In determining the proposed market data fees, the NASD represented that its staff reviewed comparable industry fees for market data. Finally, recognizing that the TRACE system is new and that participants will need time to adjust to the requirements of the TRACE Rules, the NASD proposed that the "cancel and correct" and "as/of" late fee not be charged until the later of October 1, 2002 or 90 days from the effective date of TRACE.

#### *3. TBMA's Letter*

TBMA stated that the NASD has not provided sufficient basis to determine whether the TRACE fees meet the requirements of the Act regarding equitable allocation and reasonableness. TBMA stated that the NASD failed to: (1) Reasonably substantiate its costs; (2) match revenue streams from the various fees with the costs it seeks to recover; (3) explain the relative allocation of the different categories of fees on a total revenue basis; and (4) recognize that historical trade information should be distributed and commercialized separately from real-time data. TBMA further suggested that the TRACE fees be reassessed as soon as possible after TRACE becomes effective and that the proposal be amended to reflect a pilot status.

#### *4. NASD Amendment No. 3 and Response to TBMA's Letter*

In response, the NASD submitted Amendment No. 3 establishing the TRACE fees as a six-month pilot program; the NASD also agreed to reassess the fees within six months or less after the effective date of TRACE.

In addition, the NASD addressed the issue of whether the TRACE fees meet the standards set forth in the Act. With respect to equitable allocation and unfair discrimination, the NASD noted that it has adopted a sliding scale to more equitably allocate transaction reporting fees. It noted that its fee structure allows participants to report required information according to the method that best meets their requirements based on volume, cost, and other individual needs. In addition, the NASD noted that its market data fees permit users to select the level of real-time TRACE data that they would like to receive and set up a system accordingly. Finally, the NASD provided additional justification for the reasonableness of its fees. It stated that its staff has determined the fee structure based on the best available information regarding the number of participants, debt securities transaction volume, potential use of data, etc. It represented that a number of analyses have been conducted to estimate revenue, including requesting a sample of NASD members to estimate transaction volumes and consulting market data vendors about appropriate pricing levels for market data distribution. Finally, it stated that the only development costs included in its cost estimates are those specifically related to the operation of the current TRACE system; and that, in preparing its estimates, it has projected to recover developmental costs related to TRACE over a four-year period.

The Commission believes that the NASD has adequately addressed TBMA's concerns regarding whether the TRACE fees satisfy the statutory standards regarding equitable allocation, unfair discrimination, and reasonableness. In any event, because the NASD proposes to implement the TRACE fees on a six-month pilot basis, the Commission will be able to address any concerns that arise regarding consistency with the Act at the end of the pilot program. Moreover, the NASD itself has agreed to revisit these issues prior to the expiration of the pilot.

#### **V. Accelerated Approval of Amendment No. 3**

For these reasons, the Commission finds good cause, consistent with sections 15A(b)(6) and 19(b)(2) of the

<sup>15</sup> 15 U.S.C. 78f(b)(4).

<sup>16</sup> 15 U.S.C. 78f(b)(5).

<sup>17</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>18</sup> As vendors and other market participants who review transaction information could be considered customers of TRACE, the Commission believes that the statutory provision prohibiting unfair discrimination against customers prohibits the NASD from unfairly discriminating against those vendors and market participants.

Act, to accelerate approval of Amendment No. 3 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**.

Amendment No. 3 provides that TRACE fees will operate as a six-month pilot program. Conversion of the fee filing to a pilot program will enable the Commission to re-evaluate issues relating to consistency with the Act at the end of the pilot program and recommend any needed changes to the NASD at the end of that time.

## VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3, including whether Amendment No. 3 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-2002-63 and should be submitted by July 26, 2002.

## VII. 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-2002-63), as amended, be and hereby is approved, and that Amendment No. 3 thereto is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

**J. Lynn Taylor,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46155; File No. SR-NASD-2002-92]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Day and Good-Till-Cancelled Order Designations for Non-Directed Orders and Establishing Time Priority in Nasdaq's Future Order Display and Collector Facility ("NNMS" or "SuperMontage")

July 1, 2002.

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 July 1, 2002, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq proposes to establish "Good-till-Cancelled" ("GTC") and "Day" designations for Non-Directed Orders and clarify the processing of such orders when held in Nasdaq's future Order Display and Collector Facility ("NNMS" or "SuperMontage"). In addition, to clarify the SuperMontage capability to accept, retain, display, and execute orders at multiple price levels, Nasdaq also proposes to remove the term "marketable" from the text of Rule 4706(a)(1)(B). If approved, Nasdaq will implement this rule change within 30 days after successful completion of SuperMontage user acceptance testing.

Proposed new language is italicized and deleted text is bracketed.

#### 4701. Definitions

(a) through (hh) No Change.

(ii) The term "Good-till-Cancelled" shall mean, for orders so designated, that if after entry into NNMS, the order is not fully executed, the order (or unexecuted portion thereof) shall remain available for potential display and/or execution until cancelled by the

entering party, or until 1 year after entry, whichever comes first.

\* \* \* \* \*

#### 4706. Order Entry Parameters

(a) Non-Directed Orders—

(1) General. The following requirements shall apply to Non-Directed Orders Entered by NNMS Market Participants:

(A) No Change.

(B) A Non-Directed Order must be a market or [marketable] limit order, must be a round lot or a mixed lot, must indicate whether it is a buy, short sale, short-sale exempt, or long sale, and if entered by a Quoting Market Participant may be designated as "Immediate or Cancel"[, or as a "Day" or a "Good-till-Cancelled" order. If a priced order designated as "Immediate or Cancel" ("IOC") is not immediately executable, the unexecuted order (or portion thereof) shall be returned to the sender. If a priced order designated as a "Day" order is not immediately executable, the unexecuted order (or portion thereof) shall be retained by NNMS and remain available for potential display/execution until it is cancelled by the entering party, or until 4:00 p.m. Eastern Time on the day such order was submitted, whichever comes first, whereupon it will be returned to the sender. If the order is designated as "Good-till-Cancelled" ("GTC"), the order (or unexecuted portion thereof) will be retained by NNMS and remain available for potential display/execution until cancelled by the entering party, or until 1 year after entry, whichever comes first. Starting at 7:30 a.m., until the 4:00 p.m. market close, IOC and Day Non-Directed Orders may be entered into NNMS (or previously entered orders cancelled), but such orders entered prior to market open will not become available for execution until 9:30 a.m. Eastern Time. GTC orders may be entered (or previously entered GTC orders cancelled) between the hours 7:30 a.m. to 6:30 p.m. Eastern Time, but such orders entered prior to market open, or GTC orders carried over from previous trading days, will not become available for execution until 9:30 a.m. Eastern Time. Exception: Non-Directed Day and GTC orders may be executed prior to market open if required under Rule 4710(b)(3)(B).

(C) through (E) No Change.

(F)(2) No Change.

(b) through (f) No Change.

\* \* \* \* \*

#### 4710. Participant Obligations in NNMS

(a) No Change.

(b) Non-Directed Orders

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

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

<sup>19</sup> 17 CFR 200.30-3(a)(12).