*8. Amendment No. 2*

Finally, the Commission finds good cause to accelerate approval of Amendment No. 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. In Amendment No. 2, the Board amended MSRB Rule G–15(a)(i)(C)(5) to delete the requirement that puttability or redeemability be disclosed on a transaction confirmation. In this regard, the Board also made conforming changes to MSRB Rule G–15(a)(viii)(B)(2). According to the Board, redeemability is a standard feature of municipal fund securities and, thus, the term does not serve to identify or distinguish a particular municipal fund security. Further, as a standard feature, redeemability would need to be disclosed to customers at the time of trade pursuant to MSRB Rule G–17. The Commission believes that the amendment further tailors the MSRB's rules to accommodate the unique characteristics of municipal fund securities and notes that investors will be provided with disclosure of this term. According to the information provided by the Board, redeemability is not a necessary term that needs to be set forth on a confirmation. Therefore, the Commission believes that good cause exists, consistent with section 15B(b)(2)(C) [36] and section 19(b) [37] of the Act, to accelerate approval of Amendment No. 2 to the proposed rule change.

## V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether the amendment 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 the filing will also be available for inspection and copying at the Board's principal offices. All submissions should refer to File No. SR–MSRB–00–06 and should be submitted by February 20, 2001.

## VI. Conclusion

*It Is Therefore Ordered*, pursuant to section 19(b)(2) of the Act,[38] that the proposed rule change (SR–MSRB–00–06), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[39]

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 01–2474 Filed 1–26–01; 8:45 am]

BILLING CODE 8010–01–M

[36] 15 U.S.C. 78o–4(b)(2)(C).

[37] 15 U.S.C. 78s(b).

[38] 15 U.S.C. 78s(b)(2).

[39] 17 CFR 200.30–3(a)(12).

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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–43873; File No. SR–NASD–99–65]**

## Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 4 to the Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to the Creation of a Corporate Bond Trade Reporting and Transaction Dissemination Facility and the Elimination of Nasdaq's Fixed Income Pricing System

January 23, 2001.

## I. Introduction

On October 28, 1999, 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'') [1] and Rule 19b–4 thereunder [2] to establish a corporate bond trade reporting and transaction dissemination facility and to eliminate Nasdaq's Fixed Income Pricing System (''FIPS''). Notice of the proposed rule change was published for comment in the **Federal Register** on December 10, 1999.[3] The Commission received 39 comment letters regarding the proposal.[4]

On November 17 and November 22, 2000, respectively, the NASD filed Amendment Nos. 2 and 3 to the proposed rule change.[5] Notice of these amendments was published in the **Federal Register** on November 29, 2000.[6] The Commission received 13 additional comments on the amended proposal since that time.[7] On January 5, 2001, the NASD filed Amendment No. 4 to the proposed rule change.[8] This order approves the proposed rule change, as amended by Amendments 2–4, accelerates approval of Amendment No. 4, and solicits comments from interested persons on that Amendment.

## II. Background

In 1998, Commission staff conducted a review of the U.S. debt market, with a particular focus on price transparency. The review concluded that the corporate bond market did not measure up to the standard of other securities markets—including the government and municipal bond markets—in making price information readily available to investors. In light of these findings, SEC Chairman Arthur Levitt called upon the NASD to take the following actions:

First, adopt rules requiring dealers to report all transactions in U.S. corporate bonds and preferred stocks to the NASD and to develop systems to receive and redistribute transaction prices on an immediate basis;

Second, create a database of transactions in corporate bonds and preferred stocks to enable regulators to take a proactive role in supervising the corporate debt market; and

Third, 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.[9]

In response to this request, the NASD formed the Bond Market Transparency Committee, comprised largely of market participants, to work toward an industry-guided solution to increase price transparency and oversight for the corporate debt market.

In September 1998 and March 1999, Chairman Levitt testified for the Commission before Congress on bond

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b-4.

[3] *See* Securities Exchange Act Release No. 42201 (December 3, 1999), 64 FR 69305.

[4] A list of the commenters on the proposal as originally noticed appears in Appendix A.

[5] Amendment No. 2 reflected certain changes proposed by the commenters in response to the proposed rule change, as originally noticed, or changes suggested by the NASD staff after additional review. Amendment No. 3 sets forth the statutory basis of the proposed rule change. Amendment No. 1, which had been submitted to reflect the Association's receipt of written comments from the Regional Municipal Operations Association (''RMOA''), was withdrawn, and the RMOA's comments and the NASD's response to them were incorporated in Amendment No. 2.

[6] *See* Securities Exchange Act Release No. 43616 (November 24, 2000), 65 FR 71174.

[7] A list of the commenters on Amendment Nos. 2 and 3 appears in Appendix B.

[8] Amendment No. 4 is described in Section IV.C., *infra.*

[9] Speech by Chairman Levitt, September 9, 1998, at Media Studies Center, New York, NY.

transparency; in May 1999, the Commission submitted its *Statement Concerning Transparency in the U.S. Corporate Debt Market* to the Securities Subcommittee of the Senate Banking Committee.[10] In these statements, which were approved by the Commission, Chairman Levitt described the results of the Commission's debt review, reiterated the request that the NASD improve bond transparency, and described the NASD's progress in implementing the proposal.

As noted above, in October 1999 the NASD filed the original version of the proposed rule change that is being approved today in amended form. In its general outline, the amended proposal requires NASD members to report transaction information on specified U.S. corporate bonds and establishes a transaction dissemination facility—to be known as the Trade Reporting and Comparison Entry Service, or ''TRACE''[11]—to facilitate the reporting, collection, and public dissemination of this transaction information. In its amended proposal, the NASD also states that, in accordance with the Commission's mandate, it intends to use TRACE reports to develop a database of transactions that will enable NASD Regulation (''NASDR'') to take a more proactive role in supervising the corporate debt market. The specifics of the proposed rule change are described in Section IV below.

The 39 comment letters received in response to the original proposal are summarized in Sections III and V below. Although these letters generally supported enhanced price transparency in the corporate debt markets, they raised a number of specific concerns. As a result, the NASD entered into substantial discussions with industry representatives, including The Bond Market Association (''TBMA''), aimed at responding to their comments. Subsequently, the NASD filed Amendment Nos. 2 and 3 to the proposal to reflect discussions with the industry. Commenters filed 13 additional comments in response to those Amendments; the NASD filed Amendment No. 4 to address those comments.

[10] *See* Testimony of Chairman Levitt before the Subcommittee on Finance and Hazardous Materials, Committee on Commerce, United States House of Representatives, September 28, 1998 and March 18, 1999; Statement of the U.S. Securities and Exchange Commission before the Subcommittee on Securities, Committee on Banking, Housing, and Urban Affairs, United States Senate, May 26, 1999.

[11] The NASD has represented, however, that it intends eventually to rename TRACE.

## III. Summary of Comments

The principal areas of concern reflected in the 39 initial comment letters related to potential negative effects on liquidity; the role of Nasdaq as an exclusive processor of bond data given its announced intention to become a privatized, profit-making exchange; and objections of some market participants to the associated mandatory trade comparison service. There were also concerns that the proposed implementation schedule was impractical.

Comments submitted in response to Amendments 2 and 3 suggested that those Amendments did not fully resolve all the concerns regarding the original proposal, and suggested alternative approaches to facilitate corporate bond transparency. Sections IV and V below discuss both rounds of comments, the ways in which the NASD amended its proposal to address the concerns articulated in those comments, and the Commission's findings after consideration of the comments.

## IV. Description of the Proposal

### *A. The Original Proposal*

The original TRACE proposal contemplated: (1) The adoption of new rules (''NASD/TRACE Rules'') requiring members to report transactions in specified U.S. corporate bonds (''TRACE-eligible bonds'')[12] to Nasdaq; and (2) the establishment of the TRACE facility, operated by Nasdaq, to facilitate the collection, dissemination, and comparison of reported transactions. As proposed, TRACE featured a mandatory trade comparison component for transactions between two NASD members in which a reported ''buy'' or ''sell'' would be compared with the contra side of the transaction and forwarded to the National Securities Clearing Corporation (''NSCC'') for clearance and settlement as a ''locked-in'' trade. Significantly, the NASD proposed to use TRACE reports to develop a database of transactions in corporate bonds to enable NASDR and Nasdaq Market Watch staff to take a more proactive role in surveilling the corporate bond market. Finally, the NASD proposed to eliminate the FIPS reporting system for high-yield corporate bonds.[13]

Implementation of the proposal was to take place in two phases. In the first phase of the plan, which would last six months, members were required to report transactions to TRACE within one hour after trade execution, and there was no public dissemination of transaction information. In the second phase, the one-hour reporting interval was reduced to 15 minutes, and immediate dissemination of transaction information for all reported bonds except Rule 144A issues was to begin. Trade reports were required to include: (1) Trade ''side,'' *i.e.,* whether a buy, sell, or ''cross'' transaction; (2) CUSIP number or NASD symbol; (3) quantity; (4) price, inclusive of mark-up, mark-down, and stated commission (stated commission to be reported as a separate field for agency trades); (5) contra party's NASD symbol (or ''C'' for customer); (6) date and time of trade execution; and (7) capacity, *i.e.,* principal (with riskless principal reported as principal) or agent. As noted, TRACE generally proposed to disseminate actual quantity of bonds traded expressed as par value; however, high-yield and unrated bond transactions over $1 million par value were proposed to be disseminated as ''1MM+,'' and investment grade transactions over $5 million par value were proposed to be disseminated as ''5MM+.''

### *B. Amendment Nos. 2 and 3*

In response to comments received on the initial proposal, and after extensive discussions, the NASD made six main changes to the proposal:

First, it designated the NASD as owner and operator of TRACE, removing TRACE from the control of Nasdaq;

Second, it agreed to register as an exclusive securities information processor (''ESIP'') under section 11A of the Act;

Third, it proposed a phase-in schedule for dissemination of transaction information, to permit dissemination of transaction information for larger sized bonds to begin immediately and allow smaller sized bonds to be phased-in later;

Fourth, it withdrew all proposed rules requiring trade comparison, but added a requirement that trade information provided to a member's clearing agency be provided to the NASD as well;

Fifth, it added yield to the information required to be included in the trade reports submitted by members; and

[12] TRACE-eligible bonds consist of: dollar-denominated debt securities issued by U.S. and private foreign corporations that are registered with the Commission and eligible for book-entry services at the Depository Trust Company (''DTC''); Rule 144A U.S. high-yield debt securities designated as ''PORTAL Debt Securities'' in Nasdaq's PORTAL Market; and Rule 144A investment grade debt securities eligible for book-entry services at DTC.

[13] ''FIPS'' is an acronym for the Fixed Income Pricing System operated by Nasdaq. Begun in April 1994, FIPS collects transaction and quotation information on domestic, registered, non-convertible high-yield corporate bonds.

Sixth, it established an implementation date 180 days following Commission approval of the amended proposal.

The NASD's proposed phase-in schedule contemplates the involvement of a Bond Transaction Reporting Committee (''BTRC'') to advise the NASD Board of Governors regarding liquidity issues. The BTRC will consist of eight persons selected by the NASD Board. Four members will be recommended by the staff of the NASD; the other four members will be recommended by TBMA.[14] The BTRC will provide input to the NASD Board on issues related to the operation of TRACE, including effects on liquidity associated with the dissemination of transaction information. The BTRC also will make recommendations to the NASD Board concerning appropriate time frames for public dissemination of transaction information for smaller, less-actively traded issues.[15] The NASD represents that its staff may make independent recommendations or proposals to the NASD Board concerning bond market issues. In any case, the NASD Board will have the authority and responsibility to determine how and at what pace to expand the public dissemination of transaction reports.

During the first three months of the plan (Phase I), NASD members will be required to report transactions in TRACE-eligible securities within one hour of trade execution. The NASD will immediately disseminate transaction reports in publicly offered, investment grade corporate bonds having an initial issuance size of $1 billion or greater. If applicable, these reports will include the large volume trade dissemination cap identifier (''5 MM+'') for trades of more than $5 million face value, as proposed in the original TRACE filing. Transaction reports in the high yield debt securities called the ''FIPS 50'' [16] will also be disseminated and will use the large volume trade dissemination cap identifier (''1 MM'') applicable to trades in high yield bonds of more than $1 million face value.

During this period, the BTRC will begin examining the impact of transaction information dissemination on liquidity. By the end of Phase I, the BTRC will recommend 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.

During the next six months of the plan (Phase II), NASD members will continue to report transactions within one hour of execution. The NASD will disseminate transaction reports of all transactions in the top 50% (by dollar volume) of investment grade bonds as determined by the NASD Board (subject to the approval of the SEC) after considering the recommendations of the BTRC.[17] If applicable, these reports will include the large-volume trade dissemination cap identifiers proposed in the original TRACE filing. Transaction reports in the FIPS 50 will continue to be disseminated. The BTRC will continue to evaluate the impact of dissemination of transaction information on liquidity. By the end of Phase II, the BTRC will provide recommendations for appropriate dissemination protocols for all remaining issues eligible for public dissemination. Finally, three months after the start of Phase II, the one hour maximum time period to submit trade reports will be reduced to 15 minutes, subject to the members' ability to comply technologically and operationally.

*C. Amendment No. 4*

In response to comments received regarding Amendment Nos. 2 and 3, the NASD amended its proposal to:

(1) Clarify the definition of ''TRACE-eligible securities'' in TRACE Rule 6210(a). The amendment reorganizes the definition and specifically excludes certain securities that were described as excluded in the narrative portion of the original rule filing;

(2) Delete Rule 6230(e)(2) exempting transactions in debt securities issued under section 4(2) of the Securities Act of 1933 from the TRACE reporting requirements. According to the NASD, the provision was intended to apply to debt securities issued under Section 4(2) that were not depository-eligible. Because the NASD clarified the definition of ''TRACE-eligible securities'' in Rule 6210(a) to include only depository-eligible securities, Rule 6230(e)(2) is no longer necessary;

(3) Delete proposed TRACE Rule 6231(a), which required members to report to the NASD the same transaction information the member provides to its registered clearing agency for clearance and settlement;

(4) Add language to the NASD/TRACE Rules requiring information on the FIPS 50 [19] to be publicly disseminated at the time reporting of such transactions begins under the rules;

(5) Clarify a provision in the narrative of Amendment No. 2 regarding shortening the one-hour transaction reporting interval in Rule 6230(a)(1) to fifteen minutes in the future. Amendment No. 4 modifies the proposal to clarify that Rule 6230(a)(1) requires reporting within one hour of trade execution, and states that if it seeks to reduce that reporting interval in the future, it will be required to file a proposed rule change with the Commission pursuant to Section 19(b)(1) of the Act;

(6) Withdraw the NASD's previous proposal to register with the Commission as a ''securities information processor'' under the Act;

(7) Make explicit in Rule 6250 that market aggregate and last sale information will be collected, updated, and disseminated on a continuing basis only through 5:15 p.m., although the NASD will continue to collect and disseminate information on individual transactions on a continuing basis through 6:30 p.m.; modify Rule 6250(b) to exclude the price of certain non-standard transactions in a debt security from the calculation of the market aggregate figures or the last-sale figures for such security; and

(8) Change the implementation date from 180 days after the date of Commission approval to 180 days after the date the NASD provides members with technical specifications relating to TRACE, to allow members to make the systems changes necessary to comply with the NASD/TRACE Rules.

## V. Discussion

*A. Liquidity*

As noted above, as first proposed, TRACE was intended to immediately disseminate trade reports on all reported bonds except Rule 144A issues, after an initial six-month review period. Many commenters objected to immediate dissemination of transaction information for so many reported bonds. Although most commenters supported

[14] BTRC members will not include current staff or officers of the NASD or TBMA; moreover, the NASD represents that it and TBMA will commit to selecting a broad range of bond market participants, including public participants.

[15] The NASD represents that its Board will give significant weight to the advice and recommendations of the BTRC. The NASD represents, however, that the formation and operation of the BTRC shall in no way limit or hinder the responsibility and ability of the NASD Board to make final decisions, in accordance with the statutory obligations and responsibility articulated in section 15A of the Act and the NASD By-Laws.

[16] The ''FIPS 50'' refers to 50 high-yield corporate debt issues for which transaction and quotation information is collected. The FIPS 50 are selected by a committee of NASD members from the most actively traded FIPS securities. The FIPS 50 issues are the *only* FIPS issues subject to trade reporting within five minutes after execution of a transaction—non-FIPS 50 issues need not be reported until end-of-day. In addition, the FIPS 50 are the only issues subject to dissemination of hourly trade summaries to vendors; reports on non-FIPS 50 issues are not publicly disseminated.

[17] 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. The NASD represents that it 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.

[19] See *supra* note 16.

enhanced price transparency in the corporate debt market,[20] many expressed concern that immediate dissemination of transaction information in less frequently traded corporate bonds could have a negative impact on the liquidity of those issues.[21] Specifically, these commenters contended that immediate dissemination of transaction information on less frequently traded bonds could reduce the willingness of dealers and their customers to commit capital and assume risk positions in those securities.[22] One such commenter argued that distribution of transaction information could reveal the trading patterns and intentions of market participants, making it more difficult to conduct further trades at acceptable prices. This, in turn, could result in a decline in demand and a corresponding increase in required yield for certain types of bonds, raising the overall cost of capital and decreasing the efficiency of the capital formation process.[23]

In light of this concern, TBMA suggested a phase-in framework designed to reduce the risk of any possible adverse effects on liquidity.[24] The phase-in plan provided for dissemination of transaction information for larger, more frequently traded issues first, and smaller, less frequently traded issues later. TBMA's phase-in proposal was similar to the original TRACE proposal in its approach to the time frames in which members would be required to submit trade reports. It differed from the TRACE proposal, however, in that it proposed a phase-in schedule in which transaction data on the largest sized bonds could be displayed immediately during the first six months of the plan, with smaller sized bonds to be phased-in later. The proposal was supported by many other commenters.[25]

In response to these concerns and after extensive discussions, the NASD modified its proposal to adopt the phase-in schedule described in Section IV above.[26] Under the phase-in schedule, the BTRC will advise the NASD Board of Governors regarding liquidity issues. During the first three months (Phase I), transaction information on publicly offered, investment grade bonds with an initial issuance size of $1 billion or greater, and the FIPS 50, will be distributed immediately. By the end of Phase I, the BTRC will 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. During the next six months (Phase II), TRACE will disseminate reports of all transactions in the top 50% of investment grade bonds as determined by the NASD Board (subject to the approval of the SEC) after considering the recommendations of the BTRC; and transaction reports in the FIPS 50 will continue to be disseminated. By the end of Phase II, the BTRC will recommend appropriate dissemination protocols for transactions in all remaining issues eligible for public dissemination.

All recommendations made by the BTRC will be subject to approval of the NASD Board of Governors. The Board will have the authority and responsibility to determine how and at what pace to expand the public dissemination of transaction reports.

After careful consideration, the Commission finds that the NASD's revised proposal strikes an appropriate balance between commenters' concerns about liquidity and the need to make transaction information publicly available on an immediate basis. First, the phased-in approach proposed by the NASD will permit dissemination of transaction information for only the largest sized bonds first, and that distribution of transaction information for smaller sized bonds is delayed until the impact on liquidity of the larger bonds can be assessed. Second, the involvement of the BTRC, composed in part of members recommended by TBMA, should provide the industry with meaningful participation in the phase-in process.[27] Third, because the recommendations of the BTRC are subject to approval by the NASD Board of Governors, the revised proposal ensures that the NASD will retain ultimate authority over and responsibility for the phase-in process, consistent with the Act and the NASD's obligations under the Commission's Order[28] and *Report Pursuant to Section 21(a) of the (Act) Regarding the Nasdaq Market (''Section 21(a) Report'')*.[29]

Significantly, the revised TRACE proposal provides for trade data to be made publicly available more quickly than under the original proposal. Unlike the original proposal, which contemplated no public dissemination of transaction information during the first six months, under the revised

[20] *See* D.A. Davidson Letter; Edward Jones Letter; Merrill Letter; Liberty Letter; ICI Letter; Morgan Letter; Thomson Letter; CSFB Letter; Garban Letter; Schwab Letter; SIA Letter; Warburg Letter; Legg Mason Letter; Zions Bank Letter; A.G. Edwards Letter; DLJ Letter; TBMA Letter; AMF Letter; Bear Stearns Letter; BAS Letter; Fidelity Letter; and Instinet Letter, Appendix A.

[21] *See* D.A. Davidson Letter; Liberty Letter; Morgan Letter; CSFB Letter; Garban Letter; Freeman Letter; Warburg Letter; Legg Mason Letter; Zions Bank Letter; A.G. Edwards Letter; DLJ Letter; TBMA Letter; Bear Stearns Letter; BAS Letter; Lehman Letter; ABN-AMRO Letter; Salomon Letter; and Fidelity Letter, Appendix A. Some of the commenters who opposed public dissemination of transaction information for less frequently traded bonds for *transparency* purposes nevertheless supported reporting of prices on those bonds for *regulatory* purposes. Lehman Letter; ICI Letter; Schwab Letter; TBMA Letter; Warburg Letter; Freeman Letter; and Fidelity Letter, Appendix A.

[22] *See, e.g.,* TBMA Letter, Appendix A.

[23] *See* TBMA Letter. *See also* DLJ Letter, Appendix A. In addition, some commenters were concerned that immediate distribution of trade data may damage U.S. markets by compelling U.S. institutional investors to effect their debt trades offshore. CSFB Letter; Morgan Letter, Appendix A. One such commenter stated that the movement of trading outside the U.S. would not only diminish the quality and liquidity of U.S. markets, but would also render the transaction data ''incomplete and potentially misleading.'' Morgan Letter, at 4, Appendix A. In addition, one commenter suggested that trade reports be disseminated twice per day rather than on a continuous and immediate basis. This commenter argued that twice daily distribution would provide current pricing information, especially in view of the trading frequency of even the most liquid bonds. Merrill Letter, Appendix A. Other commenters, however, supported immediate distribution of all corporate bond transaction data. One commenter in particular argued that the benefits of increased transparency outweigh any speculative concerns regarding the impact of real-time reporting on liquidity. ICI Letter, Appendix A.

[24] *See* TBMA Letter, Appendix A.

[25] *See* Morgan Letter; McFadden Letter; CSFB Letter; Freeman Letter; Warburg Letter; Legg Mason Letter; A.G. Edwards Letter; DLJ Letter; Bear Stearns Letter; BAS Letter; Lehman Letter; ABN-AMRO Letter; Zions Bank Letter; and Salomon Letter, Appendix A.

[26] *See* Amendment Nos. 2 and 3.

[27] One commenter on Amendment Nos. 2 and 3 stated that the NASD should ensure that the BTRC reflects equal representation by the ''buy-side.'' ICI Letter, Appendix B. In its filing, the NASD represents that both the NASD and TBMA will commit to selecting a broad range of bond market participants, including public representation. Under the NASD By-Laws, the Board of Governors has ultimate responsibility for the appointment of the BTRC. *See* NASD By-Laws, Article IX, Section 1 (authorizing the Board generally to ''appoint such committees or subcommittees as it deems necessary or desirable . * * *''). By contrast, the NASD staff and TBMA have authority only to *recommend* members of the BTRC under the amended TRACE proposal. Therefore, should the recommendations of the NASD staff or TBMA fail to adequately represent an industry segment, the NASD Board may disapprove those recommendations pursuant to its broad authority to appoint committees and subcommittees under the By-Laws. The Commission staff intends to monitor the progress of the TRACE phase-in as well.

[28] Securities Exchange Act Release No. 37538 (August 8, 1996).

[29] Securities Exchange Act Release No. 37542 (August 8, 1996). In the *Section 21(a) Report*, the Commission stated that the NASD, as part of its settlement, has undertaken ''to provide for the autonomy and independence of its staff with respect to disciplinary and regulatory matters. * * * Staff autonomy and independence are vital to the future effectiveness of the NASD if it is to comply with its statutory mandate. The NASD must have an environment in which they can bring to bear the objectivity, professionalism, and concern for investor protection that an SRO must always display.'' *Section 21(a) Report,* at 44.

proposal information on investment grade bonds with an initial issuance size of $1 billion or greater will be made available immediately. Distribution of information with respect to successively smaller initial issuance amounts will begin after the first three months, subject to the approval of the NASD Board, after considering the recommendations of the BTRC. On balance, the Commission believes that the immediate public availability of transaction information on the largest sized bonds, followed by the phase-in of smaller sized bonds, significantly strengthens the proposal.[30]

The Commission notes that the NASD has stated that the formula for phasing-in public dissemination of transaction information for bonds in Phase II may need to be reviewed by the BTRC in light of the fact that the Phase II formula will result in an overlap with Phase I securities that may reduce the number of newly disseminated bonds in Phase II. The Commission believes that it is reasonable for the NASD to build in this layer of guidance by the BTRC; and further, that it is appropriate for the BTRC, when making its recommendations to the NASD Board, to use its discretion to adjust applicable dissemination formulas in light of its assessment of the impact on liquidity of each phase of the TRACE dissemination schedule. In this regard, the Commission emphasizes that the NASD Board retains ultimate authority and responsibility for these matters after considering the recommendations of the BTRC.[31]

In addition, the NASD plans to reduce the time frame for reporting bond trades—from one hour to 15 minutes—during Phase II of the plan.[32] This will help ensure that transaction information is reported to TRACE and released to the public before it becomes ''stale.'' During all phases of the plan, the NASD represents that the BTRC will evaluate the technological readiness of the industry, with a view to further reducing this time frame.

Finally, the Commission believes it is significant that the revised proposal captures more information for regulatory purposes in a shorter time frame than under the original TRACE proposal. This will allow the NASD to continue to develop and refine its surveillance plan for the fixed income market.

*B. Competition*

As originally proposed, the NASD/TRACE Rules required NASD members to report their transactions in TRACE-eligible securities to Nasdaq. Nasdaq was to collect, process, and disseminate the trade reports to interested parties, and provide the information to the NASD for surveillance and other regulatory purposes.

While generally supporting increased price transparency and heightened surveillance in the OTC corporate bond market, many commenters strongly objected to Nasdaq ownership and operation of the TRACE system.[33] Several commenters argued that it was an unwarranted use of regulatory power for the NASD to give Nasdaq, a for-profit, privately (and potentially publicly) owned enterprise that might compete with other corporate bond market participants, the exclusive right to collect and disseminate bond trade data.[34] Other commenters acknowledged the NASD's legitimate interest as an SRO in obtaining corporate bond transaction information for surveillance, enforcement, and other regulatory purposes, but took issue with the NASD having the right to the commercial value of that data.[35] Some commenters stated that the NASD should not be permitted to profit from the sale and distribution of the data, suggesting instead that fees should be collected on a cost recovery basis, or that any revenue collected should be rebated to the dealer community.[36]

Other commenters objected more generally to any single entity having an exclusive franchise on collection and dissemination of corporate bond transaction data.[37] A few commenters proposed that the NASD limit its proposal to setting forth standards for transaction reporting and dissemination without mandating a specific provider.[38] Several commenters argued that mandating a single provider of bond market data would not only give the single provider the right to monopoly profits, but also would frustrate technological innovation in the area of reporting and dissemination of market data.[39]

In response to comment that the NASD/TRACE Rules, as originally proposed, could lead to granting an exclusive right over bond trade data to a private competitor in the OTC bond market (*i.e.,* a for-profit Nasdaq), the NASD submitted Amendment Nos. 2 and 3 to provide that the NASD, rather than Nasdaq, will instead own and operate the TRACE facility. In Amendment No. 2, the NASD also represented that it would register with the Commission as an exclusive securities information processor (''ESIP'') on the rationale that it would be subject to Section 11A of the Act.[40]

Comment in response to Amendment Nos. 2 and 3 was more limited than comment on the original proposal. A few commenters stated that the amendments are not an adequate response to the anti-competitive concerns raised initially, arguing that the amended proposal remains a monopoly model.[41] One commenter stated that NASD ownership of TRACE creates a conflict of interest between the

[30] With respect to the commenter who suggested that the TRACE proposal provide for twice-daily dissemination of trade reports instead of immediate and continuous dissemination, the Commission questions whether twice-daily dissemination would provide investors with timely and accurate pricing information on a wide range of bonds. Moreover, to the extent this commenter's concern is premised on anticipated negative effects on liquidity, the Commission believes that the NASD's proposed phase-in approach adequately addresses this concern, as discussed above.

[31] One commenter suggested that the NASD delegate authority over the phase-in schedule to the BTRC. *See* Morgan Letter, Appendix B. The Commission believes that such delegation would undermine the autonomy and independence of the NASD, in direct contravention of the section 21(a) Report and the NASD's obligations under the Act as a registered securities association and as a self-regulatory organization.

[32] In order to change the one-hour transaction reporting interval to fifteen minutes in the future, the NASD must submit a rule filing pursuant to section 19(b)(1) of the Act.

[33] *See* Advantage Letter; Bear Stearns Letter; Fidelity Letter; Freeman Letter; Garban Letter; Instinet Letter; Lazard Letter; Legg Mason Letter; Liberty Letter; Phlx/Bloomberg Letter; Morgan Letter; TBMA Letter; Thomson Letter; Wachovia Letter; Warburg Letter, Appendix A.

[34] *See* Freeman Letter; Garban Letter; Liberty Letter; Morgan Letter; TBMA Letter; Thomson Letter; Wachovia Letter, Appendix A.

[35] *See* Bear Stearns Letter, CSFB Letter; Fidelity Letter; Instinet Letter, Appendix A.

[36] *See* BAS Letter; Bear Stearns Letter; Freeman Letter; Garban Letter; ICI Letter; Lazard Letter; Legg Mason Letter; Merrill Letter; Morgan Letter; Schwab Letter; TBMA Letter; Warburg Letter, Appendix A. *See also* Phlx/Bloomberg Letter (arguing that proposal would cast the SEC into a ratemaking role).

[37] *See* ABN–MRO Letter; A.G. Edwards Letter; Bear Stearns Letter; CSFB Letter; Fidelity Letter; ICI Letter; Instinet Letter; Legg Mason Letter; Merrill Letter; Phlx/Bloomberg Letter; TBMA Letter; Salomon Letter; SIA Letter; Thomson Letter; Warburg Letter, Appendix A.

[38] *See* A.G. Edwards Letter; CSFB Letter; D.A. Davidson Letter; Legg Mason Letter; Merrill Letter; SIA Letter; TBMA Letter; Warburg Letter, Appendix A. *See also,* Zions Bank Letter.

[39] *See* Instinet Letter; Phlx/Bloomberg Letter; Salomon Letter; SIA Letter, Appendix A. *See also,* Thomson Letter, Appendix A.

[40] The NASD subsequently withdrew this undertaking in Amendment No. 4, stating that it will not register as a securities information processor in any capacity (either exclusive or non-exclusive), and explaining that such registration would be superfluous given that the Act vests the Commission with plenary authority to regulate the information processing and dissemination activities of the NASD.

[41] *See* Bloomberg Letter; Phlx Letter; Schwab Letter; IFI Letter, Appendix B. *See also,* Datek Letter, Appendix B.

NASD and its members.[42] This commenter stated that TRACE establishes a monopoly, and argued that if it is approved, fees for TRACE must be cost-based.[43] Two commenters stated that the NASD should not select Nasdaq as its vendor for information processing, but should instead use a competitive bidding process.[44] Other commenters noted that the Commission has established an Advisory Committee on Market Information [45] to examine whether the existing structure of market data collection and dissemination in the equity markets should be improved or replaced, and suggested that because TRACE is similar to existing models, the Commission should defer final action on the TRACE proposal until after the Advisory Committee issues its report.[46]

The NASD filed with the Commission its response to comment letters received following the publication of Amendment Nos. 2 and 3 (''Response Letter'').[47] In its Response Letter, the NASD stated that the TRACE Proposal does not give the NASD a monopoly over data collection, explaining that the NASD/TRACE Rules do not specify or limit the means by which members may report trades to the NASD. In regard to fee setting, the NASD stated that it expects to partially recover its costs of regulating the bond market through TRACE fees, and noted that the Act contemplates such regulatory cost recovery. The NASD explained that it is not accurate to characterize regulatory cost recovery as cross-subsidization of regulation because regulation ''contributes directly to the integrity, reliability, and * * * value of, market data.'' Additionally, the NASD represented that it will not sell unconsolidated data and will limit its dissemination of consolidated data to broker-dealers and to those seeking to compete in the resale of the data. Furthermore, the NASD represented that it will cease functioning as a consolidated information disseminator and limit its role to bond market regulation in the event the Advisory Committee on Market Information ''develop(s) a market-driven approach to equities market data that can be applied to bond market data.''

The Commission believes Amendment Nos. 2–4 strengthen the initial proposal, and that they should address many commenters' concerns regarding competition, without compromising the goal of increased transparency and heightened surveillance in the corporate bond market. For the reasons more fully discussed below, the Commission finds that the TRACE proposal is consistent with section 15A , including section 15A(b)(6),[48] and Section 11A(a)(1)(C) of the Act,[49] and that the proposal does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act, as required by section 15A(b)(9) of the Act.[50]

The Commission has long believed that price transparency plays a fundamental role in promoting the fairness and efficiency of U.S. capital markets, and likewise that market surveillance is a fundamental means of promoting fairness and confidence in those markets.[51] Price transparency and market surveillance go hand in hand. The key to meaningful surveillance is regulatory access to comprehensive trading information—including the information that is required for price transparency.[52]

To date, the NASD has not had routine access to comprehensive transaction information for the broad OTC corporate bond market, even though the NASD is responsible for conducting surveillance in and regulating that market.[53] As the sole SRO responsible under the Act for regulating the OTC market, the NASD is the only SRO that can effectively use consolidated bond transaction data for regulatory purposes.

The NASD/TRACE Rules require only that NASD members trading corporate bonds in the OTC market submit transaction reports to the NASD.[54] The rules exempt securities listed and traded on a national exchange.[55] A few commenters outlined alternative proposals to promote price transparency in the corporate bond market.[56] One commenter proposed that the NASD delete the listed securities exemption in the TRACE proposal, suggesting instead that multiple SROs should collect corporate bond transaction data and contribute to a ''consolidated tape'' through data linkages. This commenter further suggested that multiple SROs conduct surveillance of the corporate bond market and pass the resulting information to interested parties (*i.e.,* the Commission, the NASD, or an SRO acting as the Designated Examining Authority for the broker-dealer involved).[57] This commenter argued that such a proposal would be superior to the TRACE proposal because it would contribute greatly to ''robust competition'' and that, unlike the TRACE proposal, it would not unfairly discriminate between bonds listed on an exchange and bonds traded over-the-counter (''OTC'').[58] Another commenter proposed a ''network model,'' whereby multiple competing vendors could obtain trade reports, issue market-data for corporate bonds, and share their data with SROs and clearing agencies to facilitate surveillance and processing functions.[59] Another commenter suggested that TBMA sponsor a corporate bond transparency facility, arguing that such a facility would have greater access to expertise and would better serve the interests of bond market participants.[60]

These proposals fail to recognize that, under the Act, the NASD is the only regulator, other than the Commission itself, of the OTC market. Whereas bond transactions that take place on an exchange are regulated by that

[42] *See* Schwab Letter, Appendix B.

[43] *See* Schwab Letter, Appendix B. *See also,* Phlx Letter, Appendix B (arguing that TRACE proposal creates incentives for fees to exceed costs).

[44] *See* Morgan Letter, Schwab Letter, Appendix B.

[45] *See* Securities Exchange Act Release No. 43313 (September 20, 2000), 65 FR 58135 (September 27, 2000).

[46] *See* Datek Letter; Phlx Letter; Schwab Letter; IFI Letter, Appendix B.

[47] *See* Letter from Joan C. Conley, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Commission, dated January 5, 2001.

[48] 15 U.S.C.78*o*–3(b)(6).

[49] 15 U.S.C. 78k–1(a)(1)(C).

[50] 15 U.S.C. 78*o*–3(b)(9).

[51] *See* Statement of the U.S. Securities and Exchange Commission to the Subcommittee on Securities, Committee on Banking, Housing and Urban Affairs, United States Senate, May 26, 1999.

[52] *Id.*

[53] In enacting Section 15A of the Exchange Act (15 U.S.C. 78*o*–3), Congress determined that the over-the-counter (''OTC'') markets should be regulated by registered securities associations, rather than by the SEC. *See* S. Rep. No. 75–1455, at 1684–85 (1938). Today, the NASD remains the only registered securities association responsible for regulation of the OTC markets. Although the Municipal Securities Rulemaking Board (''MSRB'') has the authority to adopt rules governing the conduct of municipal securities dealers, it is the NASD that is responsible for enforcing those rules and conducting surveillance in the municipal securities market. To close the gap with regard to corporate bond transactions not listed on an exchange, it is logical for the NASD to require members to report OTC corporate bond transactions to the NASD.

[54] *See* TRACE Rule 6230.

[55] *See* TRACE Rule 6230(e).

[56] *See* Phlx/Bloomberg Letter, Appendix A; Schwab Letter, Appendix B.

[57] *See* Phlx/Bloomberg Letter, Appendix A.

[58] *See* Phlx/Bloomberg Letter, Appendix A (arguing that the TRACE proposal unfairly discriminates between exchange listed and OTC bonds in violation of section 15A(b)(6) of the Act).

[59] *See* Schwab Letter, Appendix B (arguing that its proposal fosters innovation, competition, minimizes the need for regulatory oversight of fees, and eliminates conflict of interest). *See also,* Datek Letter, Appendix B (arguing that open network information technology ''has emerged as one of the most revolutionary developments transforming our nation's securities markets'').

[60] *See* Morgan Letter, Appendix B.

exchange, the statutory scheme contemplates that the NASD will regulate bond transactions in the OTC market.[61] No other SRO has the necessary authority to conduct surveillance of the OTC corporate bond market. The NASD/TRACE Rules permit the NASD to obtain the information that it needs to better fulfill its statutory responsibility to regulate the OTC corporate bond market.[62] The Commission does not believe the TRACE proposal discriminates unfairly between exchange listed and OTC corporate bonds within the meaning of section 15A(b)(6) of the Act. Rather, the NASD's proposal reasonably proposes only to regulate matters within its jurisdiction.

The NASD's need for comprehensive bond transaction data to better fulfill its regulatory responsibilities cannot seriously be in dispute. Indeed, several commenters acknowledged the NASD's legitimate interest as an SRO in obtaining corporate bond transaction information for surveillance, enforcement, and other regulatory purposes.[63] Accordingly, the Commission finds that the NASD/TRACE Rules are consistent with section 15A(b)(6) of the Act, in that they further empower the NASD to fulfill its statutory obligations in the OTC corporate bond market 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, and further that they do not unfairly discriminate between customers, issuers, brokers, or dealers.

As a general matter, commenters did not object to the NASD/TRACE Rules authorizing the NASD to collect corporate bond trade data for regulatory purposes. Rather, commenters were more concerned that it was anti-competitive to permit the NASD to give Nasdaq or another single entity the exclusive right to market the data.[64] The Commission believes that the NASD's amendment giving the NASD control over TRACE, in lieu of Nasdaq, addresses these concerns. The NASD is less likely to be viewed as a potential competitor than Nasdaq. Unlike Nasdaq, the NASD intends to remain a membership organization and has no plans to operate an organized market. With regard to commenters' concerns that the TRACE proposal confers a regulatory monopoly with regard to the data, the Commission believes that these concerns are overstated because the NASD is not an exclusive securities information processor by virtue of operating the TRACE system. Third parties can obtain bond transaction data, either from the NASD or directly from broker-dealers, and the proposal does not prevent these third parties from marketing the data. Furthermore, the Act has in place regulatory safeguards to prevent the NASD from taking unfair advantage of its position as a consolidator of market information. Pursuant to sections 15A and 19(b) of the Act, the Commission has authority to oversee the NASD's provision of data to third parties, including the fees that the NASD proposes to charge for the data, as well as claims of unfair denial of access.[65]

To achieve its goal of consolidating bond market data for regulatory purposes, the NASD/TRACE Rules require NASD members to ensure that the NASD receives transaction reports in a timely fashion.[66] The rules do not prevent intermediaries from collecting the data from NASD members for transmission to the NASD.[67] Moreover, the rules do not establish any exclusive rights to that information. Vendors are expected to offer value-added services, incorporating data they receive from the NASD.[68] NASD members that provide the data are free to sell or give the same information to information vendors. Once required to make trade data available in corporate bonds, bond dealers will have little remaining reason to withhold this data from vendors. Those vendors in turn are free to offer ''unconsolidated'' information products in direct competition with the NASD.[69] At the same time, the data available from the NASD will provide a reference point for measuring the accuracy and completeness of private vendors' data streams. The Commission believes that actual or potential competition from providers of unconsolidated data, some of which may include data unavailable to the NASD, will deter the NASD from charging excessive rates for consolidated data. Furthermore, the NASD's distribution of the raw data will provide competing vendors with opportunities to package the information in forms that will be useful to institutions and retail investors. Unlike the equity markets, where pricing information is easily interpreted, in the bond market, information may need to be packaged with ancillary information and analytical tools to be fully valuable to users. The mandatory transaction reporting to the TRACE system will almost certainly create competitive opportunities for market products designed to analyze and interpret the data.

Some commenters argued that TRACE creates a monopoly, and therefore, the NASD's fees for TRACE would almost certainly exceed its costs.[70] Other commenters suggested that the NASD use a competitive bidding process to select a technology vendor to keep costs down. Given the opportunities that exist for other vendors and market participants to obtain the data, either from the NASD or directly from broker-dealers, and compete with the NASD to collect and disseminate data, the Commission does not agree that TRACE fees will necessarily exceed the NASD's costs. Even in the absence of such competition, the Act limits the ability of

[61] Transaction data for corporate bonds trading on the New York Stock Exchange's Automated Bond System is reported to the NYSE.

[62] The MSRB requires dealers to report transactions in municipal securities to the MSRB. *See* MSRB Rule G–14 (establishing public availability of Daily and Comprehensive Transaction Reports disclosing price and other information on municipal securities transactions). Likewise, transaction information for bonds listed and traded on an exchange is reported to such exchange. The NASD's proposal to require its members to report OTC corporate bond transactions to the NASD simply closes a gap in regulation.

[63] *See* Bear Stearns Letter; CSFB Letter; ICI Letter, Appendix A.

[64] *See e.g.,* ABN–AMRO Letter; A.G. Edwards Letter; Bear Stearns Letter; CSFB Letter; Fidelity Letter; ICI Letter; Instinet Letter; Legg Mason Letter; Merrill Letter; Phlx/Bloomberg Letter; TBMA Letter; Salomon Letter; SIA Letter; Warburg Letter, Appendix A. *See also* Bloomberg Letter, Datek Letter, Phlx Letter, Schwab Letter; IFI Letter, Appendix B.

[65] See also discussion *infra.* The Commission also notes that in its report recommending that the Senate adopt the Securities Act Amendments of 1975, the Senate Committee on Banking, Housing and Urban Affairs stated that, ''the Commission's broad authority under the bill includes all powers necessary to ensure the regulation of the securities information processing activities of * * * exchanges and [registered securities] associations in the same manner and to the same extent as the Commission may regulate securities information processors registered and regulated under new section 11A(b).'' Senate Report No. 94–75 (Apr. 14, 1975).

[66] *See* TRACE Rule 6230.

[67] *See* NSCC Letter, Appendix B, indicating that NSCC participants may use NSCC as an intermediary to submit trade reports to the NASD.

[68] Indeed, one commenter stated that ''private initiatives to capture and distribute trade data should be able to develop freely in the marketplace'' and acknowledged that ''the NASD's proposal would not preclude the development of such other initiatives.'' *See* ICI Letter, Appendix A. Another commenter stated that TRACE ''should serve as the ultimate collector and repository of reportable trade data which will permit regulatory surveillance of the market * * * (but) should allow for the development of other alternative means of data collection and dissemination.'' *See* Fidelity Letter, Appendix A. The Commission believes the TRACE proposal will in fact allow for such alternatives.

[69] Rule 11Ac1–2(b) under the Act, which requires vendors of reported security information to offer a consolidated product, does not apply to corporate bonds.

[70] See Phlx Letter; Schwab Letter, Appendix B. *See also* Morgan Letter, Appendix B.

the NASD to charge unreasonable fees for consolidated information. The NASD proposed in Amendment No. 2 to voluntarily register as an ESIP on the rationale that, by doing so, it would become subject to certain additional regulatory safeguards set forth in section 11A(c) of the Act. The Commission finds, however, that such registration would not place meaningful additional regulatory requirements on the NASD, as the Act provides plenary authority to regulate the information processing and dissemination activities of the NASD, including the NASD's fee structure. Furthermore, by virtue of its status as an SRO, the NASD is subject to the requirements of section 15A(b)(5) [71] and (b)(6) of the Act to deliver market information on terms that are reasonable and not unfairly discriminatory.[72] Moreover, as an SRO, the NASD will establish charges and fees for TRACE by submitting a rule filing with the Commission pursuant to section 19(b)(1) of the Act. When the Commission reviews fees to be charged for market information in the context of a proposed rule change under section 19(b) of the Act, the Commission must consider whether the proposed fees are consistent with the Act. In the context of a section 19(b) filing by the NASD to establish fees and charges for TRACE, section 15A(b)(5) of the Act will be particularly important. Specifically, section 15A(b)(5) requires the ''equitable allocation of reasonable'' fees charged to any person using the facilities operated or controlled by the NASD, and as such requires that the proposed fees be reasonable and not unfairly discriminatory.[73] The Commission believes that purchasers of consolidated TRACE data are users of the TRACE facility for purposes of considering whether a section 19(b) rule filing establishing fees and charges for TRACE is consistent with the Act.

Further, in section 11A(a)(1)(C), Congress found that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure: (1) The economically efficient execution of securities transactions; (2) fair competition among brokers and dealers; and (3) the availability to brokers, dealers, and investors of information with respect to quotations and transactions in securities. The NASD/TRACE Rules further these goals by increasing the amount of public information available in the corporate bond market. Without the availability of public information, participation in this market has been limited to well-established participants who are able to devote significant resources to obtain the necessary information. By increasing public availability of information about bond prices, the NASD/TRACE Rules may encourage greater participation in the market by brokers, dealers, and investors, which will contribute to deeper markets and increased competition. The Commission believes that the TRACE proposal is tailored to achieve the important goals of increased price transparency and enhanced market surveillance in the corporate bond market; and despite some commenters' assertions to the contrary, the Commission believes that the TRACE proposal is not so broad as to eliminate the opportunity for others to compete in the marketing and dissemination of corporate bond data.

Additionally, the Commission does not agree with commenters that bond market transparency should be deferred to await the outcome of the Commission's Advisory Committee on Market Information, which is currently studying whether the traditional model for market data collection and dissemination is still appropriate. Should the Advisory Committee on Market Information conclude that an approach substantially different from the TRACE approach provides a superior way to assure price transparency in the corporate bond market, the Commission would consider such a conclusion when evaluating any NASD amendments to TRACE.[74] After careful consideration of commenters' concerns, the Commission concludes that the TRACE proposal is consistent with section 15A(b)(9) of the Act, which requires that the rules of a registered securities association not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

*C. Trade Comparison, T+1, and Straight Through Processing*

As originally proposed, the NASD/TRACE Rules included a mandatory trade comparison feature. Several commenters objected to the mandatory comparison feature of the TRACE proposal, arguing that price transparency and trade processing issues should be addressed separately.[75] A few argued that the NSCC and DTC comparison framework works well and that the NASD's proposed system was neither necessary nor efficient.[76] Other commenters objected specifically to Nasdaq having an exclusive franchise over the provision of comparison services for corporate bond trades.[77] Some commenters raised concerns that inserting the TRACE comparison proposal between the trade execution and clearance and settlement functions would hinder the transition to a T+1 settlement cycle.[78]

In response to these concerns, the NASD, in Amendment No. 2, deleted the mandatory trade comparison feature, but required TRACE participants to provide the same data on corporate bond transactions they provide to their clearing agency within the same time frame. Several commenters, in response to Amendment Nos. 2 and 3, objected to the ''optional comparison feature'' of the amended proposal, on the grounds that it could lead to confusion in the industry.[79] Additionally, several commenters urged the NASD to delete the requirement in proposed Rule 6231(a) that members report to TRACE the same information they report to their clearing agency.[80]

The Commission recognizes the value of crosschecking the trade data submitted by the reporting dealer with information from the counterparty. Nonetheless, this process should be done in the most efficient manner

[71] 15 U.S.C. 78*o*–3(b)(5).

[72] 15 U.S.C. 78*o*–3(b)(5) and (6).

[73] Additionally, section 15A(b)(6) of the Act provides that the rules of a registered securities association must not be designed ''to permit unfair discrimination between customers.'' As vendors and other market participants who review transaction information could be considered customers of TRACE, the Commission believes this provision also prohibits the NASD from unfairly discriminating against those vendors and market participants.

[74] The Commission notes that in its Response Letter, the NASD stated that it will cease functioning as a consolidated information disseminator and limit its role to bond market regulation in the event the Advisory Committee on Market Information ''develop(s) a market-driven approach to equities market data that can be applied to bond market data.'' *See* note 47 *supra*.

[75] *See* A.G. Edwards Letter; AMF Letter; Fidelity Letter; Freeman Letter; Garban Letter; Lazard Letter; Legg Mason Letter; Liberty Letter; Merrill Letter; Morgan Letter; SIA Letter; Salomon Letter; Schwab Letter; TBMA Letter, Appendix A.

[76] *See* D.A. Davidson Letter; Edward Jones Letter; J.C. Bradford Letter; RMOA Letter, Appendix A.

[77] *See* ABN–AMRO Letter; CSFB Letter; Bear Stearns Letter; Merrill Letter; Morgan Letter; Salomon Letter; TBMA Letter; Thomson Letter, Appendix A.

[78] *See* A.G. Edwards Letter; AMF Letter; D.A. Davidson Letter; DTC Letter; Freeman Letter; J.C. Bradford Letter; Morgan Letter; SIA Letter; Thomson Letter, Appendix A. *See also*, DTC Letter (stating that TRACE Proposal does not indicate whether TRACE is compatible with NSCC technology).

[79] *See* RMOA Letter; SIA Letter; SIA/Streetside Letter, Appendix B.

[80] *See* Morgan Letter; RMOA Letter; SIA Letter; TBMA Letter, Appendix B. *See also* Phlx Letter; IFI Letter, Appendix B.

possible. Commenters stated that submitting clearing information to the NASD would add significantly to a participant's burden in complying with the Rules, without providing the NASD any information it could not obtain from the participant's clearing agency. Accordingly, the NASD filed Amendment No. 4 to delete this requirement, and the Commission is accelerating approval of that amendment as more fully described in Section VI below. In this regard, the NASD has indicated that it intends to address this issue by amending Rule 6230(b) to require both the buy and sell sides of a member-to-member transaction to report to TRACE.[81] Such a proposed rule change will be subject to notice and comment under section 19(b) of the Act.The Commission finds that the NASD's amendments to scale back the TRACE proposal to delete all provisions concerning trade comparison and submission of clearing information addresses commenters' concerns about a single comparison processor. Furthermore, because the amended proposal no longer has any direct bearing on clearance and settlement, the Commission believes that the changes should eliminate any concerns that TRACE could seriously affect the industry's move to T+1 settlement.

*D. Information Required to be Reported*

As originally proposed, the NASD/TRACE Rules did not require members to include yield information in their trade reports. Commenters stated that yield information would be useful, and suggested that the NASD specify how yield should be calculated.[82] In response, the NASD amended the NASD/TRACE Rules to require reporting of yield, and specified that yield should be calculated in accordance with Rule 10b–10 under the Act.[83] We believe that the NASD has made a reasonable response to the comments, and that inclusion of yield information will enhance the usefulness of the transaction reports.[84]

*E. Scope of the Proposal*

Several commenters suggested that the NASD significantly expand the scope of the TRACE proposal. Some argued that the proposal should accommodate fixed income instruments other than corporate debt securities, to avoid forcing the industry to support multiple systems for similar products.[85] These comments generally were premised on a concern that the proposed mandatory trade comparison feature would result in needless duplication of effort and possible inconsistency with other trade comparison systems. The NASD has addressed this concern by deleting the trade comparison feature of its filing.

In response to the NASD's amendments, some commenters argued that the NASD should incorporate municipal bond requirements as well as corporate bond requirements into a single format.[86] The Commission does not disagree that a single-format approach to fixed income transparency could have merit; however, it believes the current proposal takes a reasonable first step towards providing public investors with current transaction information on corporate bonds in a uniform format, consistent with the purposes of the Act. The Commission cannot disapprove the current proposal simply because a different or more extensive approach might also have been consistent with the Act.

Finally, one commenter, responding to Amendment Nos. 2 and 3, criticized the NASD/TRACE Rules for failing to distinguish between real-time and historical data.[87] This commenter stated that an entity other than the NASD could be the distributor of historical data. In addition, this commenter urged that final NASD/TRACE Rules recognize the economic interest of broker-dealers that report this data to the NASD.[88] In this regard, the Commission understands that the treatment of historical data has been the subject of negotiations between the NASD and TBMA. Preliminarily, the Commission believes that there is no basis in the Act to distinguish between real-time and historical data collected by an SRO. However, because the NASD/TRACE Rules do not address this issue, it is not addressed here.

*F. Lack of Specificity*

Some commenters argued that the proposal is not specific enough to permit informed comment.[89] One commenter stated that the filing did not comport with Form 19b–4 under the Act because it failed to explain the competitive implications of the proposal.[90]

The Commission believes that the NASD's original notice and subsequent amendments were sufficiently detailed as to afford commenters a meaningful opportunity to comment on their impact on competition. The notice and amendments described the scope of TRACE, the key reporting requirements, and the general schedule for implementation. The Commission raised the issue of competition in its notice by specifically asking whether the method of trade report dissemination is appropriate, and whether there are ways to improve the proposed trade reporting system. The Commission received 39 comments on the original proposal, which was published well over one year ago, and 13 comments on Amendment Nos. 2 and 3, which were published in November 2000. In fact, Amendment Nos. 2 and 3 were submitted by the NASD in part to address certain competitive concerns raised by comments on the original proposal. Further, in the original notice, the

[81] *See* Response Letter, note 47 *supra*.

[82] ICI Letter; Schwab Letter, Appendix A. *See also*, Fidelity Letter, Appendix A. *See also* Morgan Letter, Appendix B.

[83] 17 CFR 240.10b–10.

[84] Commenters raised several additional concerns about the types of information required to be included in TRACE trade reports. Several commenters argued that the trade reports should include information on the amount of interest on the trades (*see, e.g.*, D.A. Davidson Letter; J.C. Bradford Letter, Appendix A). Another disagreed with the NASD's decision to include markup and markdown figures in reported prices (Briggs and Morgan Letter, Appendix A). Finally, two commenters recommended adjusting the amount of the large volume trade identifiers disclosed in the reports (Merrill Letter, ICI Letter). Because there is no current consolidated reporting system for corporate bonds, it is difficult to make a firm determination regarding what information will be most useful to investors. We believe that the NASD has made a reasonable first attempt at this, based on its extensive discussions with the industry. For example, the NASD has developed its large volume trade identifiers in consultation with the industry. Other commenters, including TBMA, have supported these identifiers. Once TRACE operates, the NASD Board will be in a better position to determine whether to modify the system, including the large volume identifiers, to reflect suggestions provided by members, vendors, and end-users. At that time, we would expect the NASD to file with the Commission, pursuant to section 19(b)(1) of the Act, proposed changes to the NASD/TRACE Rules as necessary and appropriate, based on the suggestions it has received.

[85] *See* RMOA Letter; Edward Jones Letter; D.A. Davidson Letter; A.G.Edwards Letter; Sloan Letter; and J.C. Bradford Letter, Appendix A. For example, two commenters, in response to Amendments 2 and 3, urged the NASD to work to ensure that its trade reporting function ''works within the context of ongoing industry initiatives to consolidate and expedite post-trade processing functions across all fixed income markets.'' *See* MSRB Letter, SIA Letter; SIA/Streetside Letter, Appendix B.

[86] *See* MSRB Letter; RMOA Letter; SIA Letter; SIA/Streetside Letter, Appendix B.

[87] *See* TBMA Letter, Appendix B.

[88] *Id.*

[89] *See* Morgan Letter; RMOA Letter, Appendix A. *See also*, J.C. Bradford Letter; Freeman Letter; Garban Letter, Appendix A.

[90] *See* Phlx/Bloomberg Letter, Appendix A. One commenter repeated this concern in responding to Amendments 2 and 3 to the proposal. This commenter said that the NASD's failure to provide adequate information concerning the competitive burdens of its proposal ''deprives the public of an adequate basis to comment * * * and deprives the Commission of an adequate basis for determining whether to approve it.'' Bloomberg Letter, Appendix B.

Commission sought comment on whether the proposal is consistent with the Act, thus invoking sections 3(f), 15A(b)(6), and 15A(b)(9) of the Act regarding burdens on competition and non-discrimination.[91]

*G. Problems with Rule Text*

A few commenters pointed to problems with the text of the rule. For example, one commenter stated that the proposal is internally inconsistent.[92] That commenter argued that the narrative of the original proposal and the proposed rules themselves are not consistent. For example, the narrative described several types of securities that would not be reportable, but the proposed rules did not define the securities subject to reporting in such a way that excluded those securities. The amended proposal addresses this issue by including in the NASD/TRACE Rules the types of securities that are excluded from reporting.

*H. Preference for a More Open System*

Several commenters argued that the proposal should use open architecture and competitively driven technologies rather than a single, proprietary service.[93] These comments do not appear to take into account the NASD's need for central collection of the data to create a comprehensive surveillance system. As discussed above, TRACE allows for alternative methods for submitting this information to the NASD, and does nothing to prevent dissemination of this information independently of the NASD. Moreover, as noted above, nothing in the amended NASD/TRACE Rules prevents vendors and other market participants from receiving unconsolidated information from NASD members or from packaging consolidated data from the NASD and marketing that information in direct competition with the NASD and others. Further, to the extent these comments were directed towards the proposed mandatory comparison service, the Commission believes that the NASD's decision to delete all provisions relating to trade comparison effectively responds to such objections.

*I. Timing*

Several commenters raised concerns about the original proposed timeframe for implementing the NASD/TRACE Rules.[94] Many of the issues commenters raised regarding preparations for Y2K, decimalization, and OATS are no longer a concern. The NASD/TRACE Rules will be implemented 180 days after the date the NASD provides technical specifications to its members, in accordance with the phase-in schedule discussed above. The Commission believes that this timeframe will allow ample time for NASD members and other bond market participants to prepare for TRACE reporting, and permit the NASD to more fully test TRACE technology.

In response to Amendments 2 and 3, one commenter continued to express concerns about the revised implementation schedule for TRACE.[95] This commenter stated that members will be unable to meet the requirement to report transactions within 15 minutes after trade execution, scheduled to take effect on December 31, 2001. In this connection, the Commission notes that there is no 15-minute requirement in the rules at this time.[96] The Commission will have the opportunity to reconsider this issue if and when the NASD submits a rule change to implement a 15-minute reporting requirement.

*J. Fees*

Several commenters addressed the issue of fees, urging that fees be cost-based and account for costs incurred by NASD members who are required to report.[97] The Commission notes that the NASD/TRACE Rules as proposed do not contain proposed fees for distributing reported data. Thus, this approval order does not address the issue of fees. As noted above, the NASD is required to file a proposed rule change with the Commission prior to imposing fees, and the Commission must find that those fees are reasonable and not unfairly discriminatory under the Act.[98]

*K. Impact on Competition, Efficiency and Capital Formation*

Section 3(f) of the Act requires that the Commission consider whether the NASD's proposal will promote efficiency, competition, and capital formation.[99] As described above, the NASD proposal followed a Commission staff review of the debt market. Specifically, in 1998 Commission staff reviewed the market for debt securities in the U.S., with particular emphasis on the state of price transparency. One of the chief goals of the review was to identify specific inadequacies in the availability of pricing information in the various market segments. The review focused on five segments of the debt market: U.S. Treasury and Federal Agency Bonds; mortgage-backed securities and other structured products; corporate bonds; municipal bonds; and foreign sovereign bonds. Commission staff interviewed over thirty organizations, including trade associations, SROs, government agencies, interdealer brokers, information vendors, bond dealers, institutional investors, clearing agencies, and electronic trading system operators. The staff concluded that the quality of pricing information available in the market for government bonds was good, but that information available on high yield corporate bonds was relatively poor, and that pricing information on investment grade corporate bonds fell between high yield corporate bonds and government bonds in terms of quality.

The staff concluded that real-time transaction reporting for corporate bonds, in addition to improving the transparency of the corporate debt market, would also provide a sound basis for surveillance of that market. As a result of the findings of the review, Chairman Levitt requested the NASD to undertake the current TRACE initiative.

The Commission believes that the NASD/TRACE Rules represent a reasonable effort by the NASD to enhance the quality of the OTC corporate debt market by providing more information to investors and other market participants, thus increasing overall market transparency. While the NASD/TRACE Rules provide for a centralized collection and dissemination of bond transaction data, this centralized collection is needed to create a complete surveillance database. It does not create an exclusive means of collecting and distributing that information to investors. The NASD/TRACE Rules also will improve

[91] *See* Securities Exchange Act Release No. 42201 (December 3, 1999), 64 FR 69305 (December 10, 1999). *See also*, Securities Exchange Act Release No. 43616 (November 24, 2000), 65 FR 71174 (November 29, 2000) (requesting comment on the amended TRACE proposal).

[92] *See* Wachovia Letter, Appendix A.

[93] *See* Thomson Letter, Appendix A. *See also* McFadden Letter; TBMA Letter, Appendix A; Datek Letter; Schwab Letter; Morgan Letter, Appendix B.

[94] *See* A.G. Edwards Letter; D.A. Davidson Letter; Edward Jones Letter; Freeman Letter; Garban Letter; Legg Mason Letter; Liberty Letter; Schwab Letter; SIA Letter; Sloan Letter; TBMA Letter; Wachovia Letter; Zions Bank Letter, Appendix A.

[95] *See* RMOA Letter, Appendix B.

[96] In its Response Letter, the NASD noted that any proposal to shorten the one hour reporting period to 15 minutes would require the filing of a rule proposal pursuant to Section 19(b)(1) of the Act. The NASD represented that in developing such a proposal it will give substantial weight to the industry's timeline for implementing T+1. *See* Response Letter, note 47 *supra*.

[97] *See* BAS Letter; Bear Stearns Letter; Freeman Letter; Garban Letter; ICI Letter; Lazard Letter; Legg Mason Letter; Merrill Letter; Morgan Letter; Schwab Letter; TBMA Letter; Warburg Letter, Appendix A; Phlx Letter; Schwab Letter, Appendix B. *See also* Phlx/Bloomberg Letter (arguing that proposal would cast the SEC into a ratemaking role), Appendix A.

[98] *See* discussion *supra*, Section V.B.

[99] 15 U.S.C. 78c(f).

surveillance of the OTC corporate debt market. Moreover, they may create an opportunity for vendors and broker-dealers to market analytical tools to interpret the data. In addition, the Commission believes that the NASD/TRACE Rules proposal should promote competition and capital formation by encouraging increased participation in the corporate bond market by broker, dealers, and investors. Finally, the Commission believes that broad public availability of transaction information will increase the fairness and efficiency of the debt markets and thereby foster investor confidence in those markets. Enhanced investor confidence, in turn, may yield increased investor participation in the markets, which in turn would lead to greater liquidity in the markets.

## VI. Accelerated Approval of Amendment No. 4

The Commission finds good cause for approving Amendment No. 4 to the proposal prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. First, in response to comment, Amendment No. 4 deletes proposed Rule 6231(a) which required NASD members to report to TRACE the same transaction information that the member provides to its registered clearing agency for clearance and settlement, by the time the member transmits that information to its clearing agency.

Second, Amendment No. 4 withdraws the NASD's earlier undertaking to register as a securities information processor. As discussed *supra,* the Commission believes that the Act provides it with substantially similar oversight of the NASD's operation of TRACE whether it registers as a securities information processor or not.

In addition, Amendment No. 4 adds language to Rule 6260(a) that provides for the NASD to immediately disseminate transaction information on the ''FIPS 50.'' [100] This language was inadvertently omitted from Rule 6260(a) in the NASD's amended proposal; however, the language was included in the notice of the original proposal and in the description of transaction dissemination contained in the NASD's Amendment No. 2.

The proposed changes to the definition of ''TRACE-eligible securities'' in Amendment No. 4 clarify the rules by inserting exclusions from reporting that were contained in the narrative of the original filing. Amendment No. 4 also narrows the reporting requirement so as not to include certain investment grade securities issued pursuant to section 4(2) of the 1933 Act, but not sold or traded under Rule 144A. The Commission believes that this change will not substantially alter the scope of reporting required under the NASD/TRACE Rules.

Finally, the revised implementation schedule provides 180 days time for the industry to prepare for TRACE after technical specifications are made available, rather than 180 days after Commission approval. This change responds to commenters suggestions, and the Commission believes that commenters would likely welcome the additional time to prepare for TRACE.

Other changes effected by Amendment No. 4 are technical in nature and were added for clarification only.

For these reasons, the Commission finds good cause, consistent with sections 15A(b)(6) and 19(b)(2) of the Act, to accelerate approval of Amendment No. 4 to the proposed rule change.

## VII. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 4, including whether Amendment No. 4 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–99–65 and should be submitted by February 20, 2001.

## VIII. 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–99–65), as amended, be and hereby is approved, and that Amendment No. 4 thereto is approved on an accelerated basis.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

## Appendix A—List of Comment Letters NASD's Original Trace Proposal SR–NASD–99–65

1. Letter from William T. Dolan, Briggs and Morgan, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated January 14, 2000 (''Briggs and Morgan Letter'').
2. Letter from Thomas Sargant, President, Regional Municipal Operations Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated January 27, 2000 (''RMOA Letter'').
3. Letter from Douglas L. Williams, Executive Vice President, Wachovia Securities, Inc., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 4, 2000 (''Wachovia Letter'').
4. Letter from Dennis J. Dirks, Chief Operating Officer, The Depository Trust & Clearing Corporation, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 8, 2000 (''DTC Letter'').
5. Letter from Kreg Jones, Sr. Vice President, and George Tootle, Vice President, D.A. Davidson & Co., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 7, 2000 (''D.A. Davidson Letter'').
6. Letter from Thomas J. Westphal, Principal, Operations, Edward Jones, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 4, 2000 (''Edward Jones Letter'').
7. Letter from Thomas M. Likovich, Managing Director, U.S. High Grade Credit Trading, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 8, 2000 (''Merrill Letter'').
8. Letter from Louis J. Scotto, President, Liberty Brokerage Securities, Inc., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 7, 2000 (''Liberty Letter'').
9. Letter from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 8, 2000 (''ICI Letter'').
10. Letter from Kenneth deRegt, Managing Director, Morgan Stanley & Co, Incorporated, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 8, 2000 (''Morgan Letter'').
11. Letter from Mari-Anne Pisarri, Pickard and Djinis LLP, on behalf of Thomson Financial, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 8, 2000 (''Thomson Letter'').
12. Letter from Rene L. Robert, President, AdvantageData.com, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 7, 2000 (''Advantage Letter'').
13. Letter from Alan M. Green, Managing Partner, McFadden, Farrell & Smith, to Jonathan G. Katz, Secretary, Securities and

[100] *See supra* note 16.

Exchange Commission, dated February 7, 2000 (''McFadden Letter'').

14. Letter from F. Harlan Batrus, Managing Director, Lazard Freres & Co, LLC, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 9, 2000 (''Lazard Letter'').

15. Letter from Richard E. Thornburgh, Vice Chairman of the Executive Board, Member of the Credit Suisse Group Executive Board, Credit Suisse First Boston, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 8, 2000 (''CSFB Letter'').

16. Letter from Salvatore Trani, President, Garban Corporates LLC, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 9, 2000 (''Garban Letter'').

17. Letter from J.P. Lademark, Senior Vice President, Schwab Capital Markets & Trading Group, Charles Schwab & Co., Inc., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 11, 2000 (''Schwab Letter'').

18. Letter from James F. Smith, President, Freeman Securities Company, Inc., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 10, 2000 (''Freeman Letter'').

19. Letter from Noland Cheng, Chairman, Fixed Income Transparency Subcommittee of SIA's Operations Committee, Securities Industry Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 10, 2000 (''SIA Letter'').

20. Letter from Robert Wolf, Managing Director, Warburg Dillon Read LLC, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 9, 2000 (''Warburg Letter'').

21. Letter from Joseph A. Sullivan, Senior Vice President and Director, Fixed Income Group, Legg Mason Wood Walker, Incorporated, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 10, 2000 (''Legg Mason Letter'').

22. Letter from Robert G. Knox, Zions Bank Capital Markets, Zions First National Bank, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 10, 2000 (''Zions Bank Letter'').

23. Letter from Ronald J. Kessler, Corporate V.P. & Director of Operations, and Gregory C. Menne, Sr. V.P. & Director of Fixed Income, A.G. Edwards & Sons, Inc., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 10, 2000 (''A.G. Edwards Letter'').

24. Letters from David DeLucia, Managing Director, Donaldson, Lufkin & Jenrette, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 9, 2000 and February 23, 2000 (collectively, ''DLJ Letter'').*

25. Letter from William H. James III, 1999 Chairman Corporate Bond Division; Vincent P. Murray, 2000 Chairman, Corporate Bond Division; Ferdinand Masucci, 2000 Vice Chairman, Corporate Bond Division, The Bond Market Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 9, 2000 (''TBMA Letter'').

26. Letter from Joseph W. Sack, Executive Director, and Judith D. Donahue, The Capital Group Chairman, The Bond Market Association, Asset Managers Forum, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 11, 2000 (''AMF Letter'').

27. Letter from Robert B. Sloan to Secretary, Securities and Exchange Commission, dated February 14, 2000 (''Sloan Letter'').

28. Letter from Warren J. Spector, Senior Managing Director, Bear Stearns & Co., Inc., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 10, 2000 (''Bear Stearns Letter'').

29. Letter from Stephen J. Gallagher, Managing Director, Global High Grade Trading, Banc of America Securities LLC, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 10, 2000 (''BAS Letter'').

30. Letter from Steven Berkenfeld, Managing Director, Lehman Brothers, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 10, 2000 (''Lehman Letter'').

31. Letter from Brian Riano, Managing Director, Corporate Bond Secondary Trading, Salomon Smith Barney, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 23, 2000 (''Salomon Letter'').

32. Letter from David Russell, Jr., Cove Hill Consulting, Inc., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 10, 2000 (''Cove Hill Letter'').

33. Letter from Sarah Cohen, Director, Fixed Income Syndicate, ABN–AMRO, Incorporated, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 9, 2000 (''ABN AMRO Letter'').

34. Letter from Kevin M. Foley, Bloomberg L.P., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 15, 2000 (''Bloomberg Letter'').

35. Letter from Meyer S. Frucher, Philadelphia Stock Exchange, Inc., and Kevin M. Foley, Bloomberg L.P., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 15, 2000 (''Phlx/Bloomberg Letter'').

36. Letter from Peter Fenichel, Senior Vice President, Instinet Fixed Income, Instinet Corporation, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated April 4, 2000 (''Instinet Letter'').

37. Letter from Eric Broder, Partner, Director of Operations, J.C. Bradford & Co., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 11, 2000 (''J.C. Bradford Letter'').

38. Letter from Dwight D. Churchill, Senior Vice President and Bond Group Leader, Fidelity Investments, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 28, 2000 (''Fidelity Letter'').

*Donaldson, Lufkin & Jenrette submitted two comment letters, the second elaborating on points made in the first. For ease of reference, both letters are collectively referred to as the ''DLJ Letter.''

**Appendix B—List of Comment Letters: Amendment Nos. 2 and 3 to SR–NASD–99–65**

1. Letter from Thomas Sargant, President, Regional Municipal Operations Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 13, 2000 (''RMOA Letter'').

2. Letter from William H. James, III, 1999 Chairman, Corporate Bond Division, Vincent Murray, 2000 Chairman, Corporate Bond Division, and Thomas Thees, 2001 Chairman, Corporate Bond Division, The Bond Market Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 20, 2000 (''TBMA Letter'').

3. Letter from Barry E. Simmons, Associate Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 20, 2000 (''ICI Letter'').

4. Letter from Zoe Cruz, Managing Director, Morgan Stanley Dean Witter, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 20, 2000 (''Morgan Letter'').

5. Letter from W. Hardy Callcott, Senior Vice President & General Counsel, Charles Schwab & Co., Inc., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 20, 2000 (''Schwab Letter'').

6. Letter from Noland Cheng, Chairman, Fixed Income Transparency Subcommittee of Securities Industry Association Operations Committee, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 21, 2000 (''SIA Letter'').

7. Letter from Eleanor Davis Ainspan, Chairperson, T+1 Streetside Fixed Income Working Group, SIA, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 21, 2000 (''SIA/Streetside Letter'').

8. Letter from Kevin M. Foley, Bloomberg L.P., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 22, 2000 (''Bloomberg Letter'').

9. Letter from Edward J. Nicoll, Chairman and Chief Executive Officer, Datek Online Holdings Corp., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, undated, received by e-mail on December 26, 2000 (''Datek Letter'').

10. Letter from Meyer S. Frucher, Chairman and Chief Executive Officer, Philadelphia Stock Exchange, Inc., to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 26, 2000 (''Phlx Letter'').

11. Letter from Dennis J. Dirks, Chief Operating Officer, Depository Trust & Clearing Corporation, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 28, 2000 (''DTC Letter'').

12. Letter from Christopher A. Taylor, Executive Director, Municipal Securities Rulemaking Board, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated January 3, 2001 (''MSRB Letter'').

13. Letter from Peter Rich, Senior Vice President, Government and Regulatory Affairs, Instinet Fixed Income, Instinet Corporation, Inc., to Jonathan G. Katz,

Secretary, Securities and Exchange Commission, dated January 5, 2000 (''IFI Letter'').

[FR Doc. 01–2440 Filed 1–26–01; 8:45 am]

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## SOCIAL SECURITY ADMINISTRATION

### Statement of Organization, Functions and Delegations of Authority

This statement amends Part S of the Statement of the Organization, Functions and Delegations of Authority which covers the Social Security Administration (SSA). Chapter S2 covers the Deputy Commissioner, Operations. Notice is given that Subchapter S2N, the Office of Public Service and Operations Support (OPSOS), is being amended to reflect the establishment of the Division of Systems Security and Program Integrity (S2NE) under the Associate Commissioner for Public Service and Operations Support. The remaining divisions in OPSOS are being retitled to more accurately reflect their functions. The functions in two of the three existing divisions are being realigned. The new material and changes are as follows:

**Section S2N.10 The Office of Public Service and Operations**

*Support—(Organization)*

Retitle

D. The ''Division of Service Delivery and Program Policy'' (S2NA) to the ''Division of Program Policy and Operations'' (S2NA).

E. The ''Division of Operations Management'' (S2NB) to the ''Division of Operations Analysis and Customer Service'' (S2NB).

F. The ''Division of Resource and Management Information'' (S2NC) to the ''Division of Resource Management and Employee Services'' (S2NC).

Establish

G. The Division of Systems Security and Program Integrity (S2NE).

**Section S2N.20 The Office of Public Service and Operations**

*Support—(Functions)*

C. The Immediate Office of the Associate Commissioner for Public Service and Operations Support (S2N): Delete the final sentence, *i.e.,* ''Coordinates and implements a comprehensive DCO nationwide program to focus on systems security and programmatic fraud.''

Retitle

D. The ''Division of Service Delivery and Program Policy'' (S2NA) to the ''Division of Program Policy and Operations'' (S2NA).

Delete

Functional statement numbers 7 through 12.

Retitle

E. The ''Division of Operations Management'' (S2NB) to the ''Division of Operations Analysis and Customer Service'' (S2NB).

Delete

Functional statement number 5.

Add

5. Participates with appropriate policy components in SSA to provide clear, accurate and timely notices to the public and to fully utilize automation to reduce the need for manually prepared notices.

6. Develops and recommends to DCO standards and practices for national and international delivery of services. Plans, implements and evaluates the full range of SSA's service to the public.

7. Establishes service delivery policies. Develops and evaluates standards for measuring service to the public to ensure that quality, efficient and compassionate service is provided.

8. Plans, conducts and evaluates public information/referral programs to ensure Agency and other public and private services are effectively provided to the community within the guidelines and direction provided by the Agency. Ensures SSA's public affairs/information efforts are implemented effectively and efficiently within DCO components.

9. Establishes policies and develops criteria on field office accessibility (hours of service, size of field offices, type and location of services, etc.).

10. Directs the planning, analysis and evaluation of field office structure and develops innovative concepts for the future role of DCO components, including improvements in service.

Retitle

F. The ''Division of Resource and Management Information'' (S2NC) to the ''Division of Resource Management and Employee Services'' (S2NC).

Establish

G. The Division of Systems Security and Program Integrity (S2NE).

1. Coordinates and implements a comprehensive DCO nationwide program to focus on systems security and programmatic fraud.

2. Conducts nationwide analyses and studies to identify potential problems and develops guidelines/procedures to ensure an effective and efficient Operations security and integrity program.

3. Develops and maintains a comprehensive national program to focus attention on combating beneficiary and recipient fraud and develops recommendations for improving operational policy, procedures and internal controls to prevent recurrence.

4. Assesses security vulnerabilities. Evaluates overall plans and proposals for major Agency and interagency security projects and provides analysis for use in security program planning, implementation, evaluation and modification efforts.

5. Implements national level guidance in Agency standards, guidelines, or policies for major security programs.

6. Provides direction and coordination to the activities of the Regional Centers for Security and Integrity.

7. Ensures that training on security and program integrity is available and maintains a continuing awareness program.

8. Develops or interprets general policy direction for application on an organization-wide basis and conducts oversight reviews on the effectiveness of programs and practices.

9. Advises top-level DCO executives and security managers on new developments and advances in security techniques and keeps them informed of sensitive issues regarding beneficiary/recipient fraud, employee fraud and systems abuses.

10. Creates workflows and processes with systemic safeguards to prevent errors and ensure a full audit trail for automated and paper products.

11. Provides direction and coordination on sensitive cases involving employee fraud and abuse, including providing guidance to Operations executives regarding the appropriate disciplinary action.

12. Serves as Operations representative on the Agency's Critical Infrastructure Response Team responsible for responding to external and internal threats to the Agency's systems architecture.

13. Develops Operations systems access matrixes for new and/or existing applications to support the Agency's policy of least privilege access to SSA's various computer systems and monitors the profiles created to ensure the level of access is appropriate based on job duties and function of the application.