

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49854; File No. SR-NASD-2004-057)

June 14, 2004

Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the National Association of Securities Dealers, Inc. Relating to Proposed Amendments to Reduce the Reporting Period for Transactions in TRACE-Eligible Securities

On April 1, 2004, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend Rule 6230(a) to reduce the period to report a transaction in a TRACE-eligible debt security in two stages: (i) from 45 to 30 minutes in stage one (“Stage One”), and (ii) subsequently, from 30 to 15 minutes in stage two (“Stage Two”). Rule 6230 is one of the Trade Reporting and Compliance Engine (“TRACE”) rules. On April 16, 2004, NASD filed Amendment No. 1 to the proposed rule change.³ On April 22, 2004, NASD filed Amendment

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Sharon K. Zackula, Assistant General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, SEC, dated April 16, 2004 (“Amendment No. 1”). Amendment No. 1 clarifies the effective dates that NASD will establish for the proposed rule change upon approval by the Commission.

No. 2 to the proposed rule change.⁴ Notice of the proposed rule change and Amendment Nos. 1 and 2 thereto were published for comment in the Federal Register on April 29, 2004.⁵

The Commission received two comment letters regarding the proposal.⁶ On June 2, 2004, NASD filed a response to the comment letters.⁷ This order approves the proposed rule change.

After careful consideration, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations promulgated thereunder applicable to a registered securities association and, in particular, with the provisions of Section 15A(b)(6) of the Act⁸, which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.⁹ The

⁴ See letter from Sharon K. Zackula, Assistant General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, SEC, dated April 22, 2004 (“Amendment No. 2”). Amendment No. 2 amends the discussion of industry and regulatory trends in the securities industry favoring more “real-time” reporting and “real-time” transmission of transaction information for clearance and settlement.

⁵ Securities Exchange Act Release No. 49607 (April 23, 2004), 69 FR 23549.

⁶ See e-mail letter from Richard F. Seifer, President and C.E.O., Bernard, Richards Securities Inc., to rule-comments@sec.gov dated May 10, 2004 (“Mr. Seifer’s Letter”), and e-mail letter from Alan H. Schlesinger, Sage Securities Corp., to rule-comments@sec.gov dated May 20, 2004 (“Mr. Schlesinger’s Letter”).

⁷ See letter from Sharon K. Zackula, Associate General Counsel, Regulatory Policy and Oversight, Office of General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, SEC, dated June 2, 2004 (“NASD’s Response Letter”).

⁸ 15 U.S.C. 78o-3(b)(6).

⁹ In approving this proposed rule change, the Commission has considered the proposal’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

Commission believes that the proposed rule change, as amended, will provide NASD, as the self-regulatory organization for the over-the-counter markets, with appropriate capabilities to regulate and provide surveillance of the over-the-counter debt securities market to prevent fraudulent and manipulative acts and practices, and will improve transparency for the benefit of investors by reducing the period between the time of execution of a transaction and the dissemination of transaction information for securities subject to dissemination in furtherance of the public interest and for the protection of investors.

Both commenters on the proposal opposed any further reduction of the period to report a transaction in a TRACE-eligible debt security. Mr. Seifer's Letter expressed concern that decreasing the reporting period would leave a reporting window insufficient to allow the proper reporting of TRACE-eligible securities and would create a market environment where the immediate needs of a customer would have to be put on hold to comply with the requirements of TRACE reporting. Mr. Schlesinger's Letter stated that the mechanics of the corporate bond marketplace and the equity marketplace are distinctly different, and that reducing the reporting time of trades on TRACE to what is appropriate for an equity trade on Nasdaq is mistaken.

NASD's Response Letter states that current reporting statistics support its position that member firms have taken, and continue to take, the steps necessary to meet the proposed TRACE requirement of 30-minute, and subsequently, 15-minute reporting. NASD stated that during the first four months of 2004, approximately 84 percent of all transactions in TRACE-eligible securities were reported within 30 minutes, and approximately 73 percent of all TRACE-eligible securities transactions were reported within 15 minutes, although a 45-minute reporting period was in effect. NASD further stated that both NASD and the SEC have provided notice over a period of years that 15-minute TRACE reporting was a regulatory goal, pointed out that

NASD is proposing a two-stage process to allow firms to implement the measures necessary to comply with 15-minute reporting, and stated that NASD consulted extensively with member firms and industry associations in developing this two-stage process. In response to the concern that NASD is trying to reduce the TRACE reporting period to one that is feasible for equity securities, NASD noted that the current reporting requirement for equity securities is 90 seconds, a significant difference from the current proposal to reduce the reporting period to 30 minutes, and later, to 15 minutes.

Both commenters stated that reducing the TRACE reporting period would increase members' costs of trading TRACE-eligible securities. Mr. Seifer's Letter stated that TRACE has added layers of expense for both clearing and non-clearing firms by expanding the need for additional personnel and imposing fines against brokers for late TRACE reporting. Mr. Schlesinger's Letter stated that his firm would incur significant costs in technology and personnel in order to be compliant with the reduced reporting period.

NASD's Response Letter states that the two-stage process is being used to minimize the impact to firms as they make any necessary changes, including the costs of such changes. By extending the period over which the TRACE reporting period will be reduced, NASD stated that it believes that firms should be able to prepare more efficiently to make the changes needed to achieve 15-minute reporting.

NASD's Response Letter respectfully disagreed with Mr. Seifert's comment that TRACE does not provide transparency for the general public. NASD stated that public investors and other market participants have been provided increased transparency in the corporate bond markets as a direct result of TRACE. NASD stated that transaction information currently is publicly disseminated on approximately 70 percent of the total par value traded in investment-

grade TRACE-eligible securities. NASD further stated that members of the public may access last sale pricing at no cost in these debt securities at NASD's Web site, <http://www.nasdbondinfo.com>, or at other Web sites, such as that of The Bond Market Association (<http://www.investinginbonds.com>). Pricing information on these Web sites is delayed at least four hours. Information on certain actively traded bonds is also published daily in The Wall Street Journal. Members of the public seeking more immediate access to transaction data may contract to receive disseminated transaction data from commercial vendors. NASD also stated that it expects transaction information to be more widely available in the future.

In addition, Mr. Schlesinger's Letter expressed concern that the "time of execution" for a transaction in a TRACE-eligible security within the meaning of NASD Rule 6210(a) is not clear. Mr. Schlesinger stated that "a meeting of the minds" evidencing an executed transaction does not occur "until a report is given and accepted." NASD's Response Letter states that NASD believes that this is an inaccurate description of an execution, and notes that executing a transaction precedes the steps described by Mr. Schlesinger, which are those generally taken to confirm a trade previously executed.

In addition, Mr. Seifer recommended that TRACE be funded as part of the NASD annual assessment for each member firm and Mr. Schlesinger stated that the reporting of agency transactions as if they were principal transactions can be confusing and cumbersome. This proposed rule change, as amended, does not address those issues.

After careful consideration, the Commission believes that NASD's reduction in the reporting period for transactions in TRACE-eligible securities will enable it to implement TRACE more effectively, thus enhancing investor protection by improving the immediacy of information reported to TRACE for both regulatory and transparency purposes. For the reasons

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

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act¹⁰, that the proposed rule change, as amended, (SR-NASD-2004-057), be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland
Deputy Secretary

¹⁰ Id.

¹¹ 17 CFR 200.30-3(a)(12).