



THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

November 17, 1999

The Honorable John D. Dingell
Ranking Member
Committee on Commerce
2322 Rayburn House Office Building
U.S. House of Representatives
Washington, DC 20515

Dear Congressman Dingell:

Last September, you asked the Commission to provide you with annual progress reports, through the year 2003, on SEC and industry initiatives to improve corporate bond transparency. Today, I am pleased to provide this second in a series of annual reports, prepared by the Division of Market Regulation, on corporate bond transparency.

I appreciate your interest in this issue. Please do not hesitate to call me or Annette L. Nazareth, Director, Division of Market Regulation, at 202/942-0090, if we can be of further assistance.

Sincerely,

A handwritten signature in black ink, appearing to be "A. Levitt", written over the printed name.

Arthur Levitt

enclosure

MEMORANDUM

TO: Chairman Levitt

FROM: Annette L. Nazareth 

RE: Corporate Bond Transparency

DATE: November 16, 1999

Last September, in connection with your call for improved transparency in the corporate bond market, Congressman John Dingell asked the Commission to submit annual progress reports to the Commerce Committee regarding corporate bond transparency. These reports, to be provided through the year 2003, are to contain a discussion of regulatory and industry initiatives in this area, to permit the Committee to determine how much progress has been made. Today I am pleased to provide you with this progress report for transmittal to Congressman Dingell.

Two major initiatives have been launched since last Fall. The first initiative was developed by the Bond Market Association ("TBMA") and is called Corporate Trades I. Corporate Trades I electronically displays transactions in investment grade bonds through private data vendors and the Internet. It covers only transactions by interdealer brokers and displays reports on an end-of-day basis. The service has operated since the Spring of 1999. A TBMA Website, www.investinginbonds.com, provides investors with free access to the data.

We believe that Corporate Trades I is a good first step. It provides useful transaction information for the first time in the over-the-counter corporate debt market. In addition, it paves the way for enhanced public access to meaningful trade data by demonstrating the feasibility of improved price reporting in the corporate debt markets. On the other hand, it is significantly limited in that it covers only investment grade bonds traded through interdealer brokers that voluntarily participate. And the necessarily limited information it displays cannot be used to create the comprehensive database that we think is necessary to effectively surveil the corporate bond market.

The second initiative, undertaken by the NASD and shaped by its Bond Market Transparency Committee, is more comprehensive than TBMA's. Specifically, on October 27, 1999, the NASD filed with the Commission a proposal requiring its members to report transaction information on corporate bonds and establishing a facility -- called the Trade Reporting and Comparison Entry Service ("TRACE") -- to facilitate the comparison, reporting, and clearance and settlement of these trades. Significantly, reporting obligations under the NASD's rules will apply to a broader universe of bonds than TBMA's initiative -- DTC-eligible, U.S. dollar-denominated debt securities issued

by U.S. and foreign private corporations will be covered under the NASD's proposal. In addition, the proposed rules will require all members to report transactions with customers as well as transactions with other broker-dealers.

Under the proposal, there will be a phase-in period. NASD members initially will report transactions within one hour of execution. After six months, members will report transactions within a shorter time interval -- 15 minutes -- after execution. The NASD will not publicly disseminate transaction reports in the first six months, with the exception of the 50 most liquid high-yield bonds (the so-called "FIPS 50"). After six months, the NASD will begin to disseminate transaction reports on all debt securities covered by the proposal through an Internet website (with query capability) and private data vendors. (The NASD will not disseminate information on Rule 144A transactions.) The information will consist of the bond's description, price, yield, and date and time of trade execution. The size of the trade will also be disseminated, subject to caps established by the NASD. For example, transactions in high-yield and unrated bonds over \$1 million in par value will be disseminated as "1MM+"; transactions in investment grade bonds over \$5 million in par value will be disseminated as "5MM+."

The TRACE system will be designed to allow vendors and service bureaus to provide data on behalf of their clients via a Nasdaq computer-to-computer interface. A browser-based software application will permit members to enter information via the Internet or other private networks.

We intend to conduct a careful review of the NASD's filing to determine whether it complies with the Exchange Act. We intend to ask for comment on a wide variety of issues, including: the types of information that should be reported, how immediate the reporting should be, and the kinds of systems changes that may be needed so that firms can easily report the information to a central facility.

There is one other development that may affect transparency of the debt market -- the rules relating to exchanges and alternative trading systems ("Reg ATS") that the Commission adopted in December 1998. As you know, Reg ATS permits most alternative trading systems to operate as broker-dealers subject to an exemption from exchange registration.

Alternative trading systems for non-exempt debt securities are generally subject to Reg ATS. Among other things, Reg ATS requires alternative trading systems to file initial operating reports with the Commission on Form ATS and periodic activity reports on Form ATS-R. We have received Form ATS filings from 15 debt systems, nine of which permit trading of corporate debt. These nine systems generally display to system subscribers real-time information regarding bids, offers, and transactions executed through the system. However, they do not publicly disseminate that information. In reviewing the NASD's proposal, we will look closely at how the proposal will facilitate the transparency of transaction information generated by alternative trading systems.