



Robert R. Glauber
Chief Executive Officer and President

December 14, 2000

The Honorable John D. Dingell
Ranking Member
U.S. House of Representatives
The House Committee on Commerce
2328 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Dingell:

In response to your letter dated September 29, 1998, the National Association of Securities Dealers, Inc. ("NASD" or "Association") is pleased to submit its second annual progress report on its efforts to achieve greater price transparency and investor protection in the corporate debt markets. Since our last progress report submitted to you a year ago, the NASD has submitted to the Securities and Exchange Commission ("SEC") its proposal for corporate bond transparency (currently referred to as "TRACE").¹ That proposal was submitted to the SEC on October 27, 1999, and published for comment on December 3, 1999. As expected, given the scope of the proposed changes, the TRACE proposal generated significant comment. Since that time, the NASD staff, in close consultation with SEC staff, has spent the last twelve months meeting with The Bond Market Association ("TBMA") and other industry representatives to craft an approach that addresses the operational, competitive, and market liquidity concerns the commenters raised without diminishing the regulatory and investor benefits of the original proposal.

As a direct result of these cooperative efforts, the NASD filed an amended TRACE proposal on November 17, 2000, which was published for comment by the SEC on November 29, 2000.² The comment period will close on December 20, 2000. The proposed amendments, detailed in the attached Exhibit A, are summarized briefly below.

TRACE Ownership, Operation, and Governance. In response to competitive concerns raised regarding the transparency initiative, the NASD took the following steps to restructure the responsibilities and clarify the roles of NASD, NASD Regulation, Inc. ("NASD Regulation"), and The Nasdaq Stock Market, Inc. ("Nasdaq"): (1) the NASD amended proposed Rule 6210 to clarify that it is the owner of the facility to collect information on fixed income transactions and to disseminate such information; (2) the NASD will establish a body of rules and policies that will

¹ Given the removal of the mandatory comparison feature (see discussion below), the NASD plans to rename the system.

² Amendment No. 2 to SR-NASD-99-65 (November 17, 2000) (attached as Exhibit A). A minor amendment, Amendment No. 3, was filed on Nov. 22, 2000. SR-NASD-99-65, Amendment Nos. 2 and 3, were noticed in SEC Rel. No. 34-43616 (Nov. 24, 2000), 65 FR 71174 (Nov. 29, 2000). SR-NASD-99-65 was first filed on October 27, 1999. SEC Rel. No. 34-42201 (Dec. 3, 1999), 64 FR 69305 (Dec. 10, 1999). Amendment No. 1, previously submitted by the Association, was withdrawn, and the issues discussed in Amendment No. 1 were incorporated in Amendment No. 2.

be the bases on which NASD staff will administer the reporting and dissemination facility and assure compliance with the TRACE rules; (3) NASD Regulation will aid the NASD in establishing appropriate regulatory rules and policies and in performing all the regulatory functions; and (4) Nasdaq will provide technology and operational support pursuant to a contractual arrangement.

To more fully understand the liquidity, regulatory, and trading issues potentially implicated by increased bond market transparency, the NASD will establish a new NASD committee, the Bond Transaction Reporting Committee ("BTRC"). Although ultimate statutory authority for all regulatory matters will reside with the NASD Board of Governors, the BTRC, consisting of 4 persons recommended by the NASD and 4 persons recommended by TBMA, will play a key role in advising the NASD Board.

Trade Comparison. To further alleviate competitive concerns raised by commenters, NASD deleted the mandatory trade comparison function that was previously proposed. This action addressed the specific competitive concerns expressed in comments that Nasdaq would obtain an exclusive franchise over the comparison services for most fixed income transactions. The elimination of mandatory comparison through TRACE will provide an opportunity for other entities to offer value-added comparison services for fixed income transactions.

In the absence of mandatory comparison, however, both compared and un-compared bond transaction data will be disseminated by the NASD. Accordingly, NASD Regulation staff had concerns about improving the quality of the audit trail for surveillance purposes. As a result, the NASD proposed that TRACE participants on both the buy and sell sides of the same transaction send a duplicate copy to the NASD of the information on TRACE-eligible trades that is normally provided to the members' registered clearing agency, within the same time frame. The NASD's proposal to require such clearing information was submitted in lieu of a proposal to require dual trade reporting to the NASD by both the buy and sell sides of each transaction³, because NASD believes that transmission of duplicate clearing reports is less burdensome and will satisfy most of NASD Regulation's needs with respect to developing a complete audit trail for surveillance purposes.

Collection and Dissemination of TRACE Data. In response to concerns raised regarding the potential operational and liquidity impacts of dissemination of transaction information, the NASD streamlined the original proposal and proposed the following two phases, to be followed by additional phases to be determined at a later date. Phase I, which includes the largest issues, extends for the first 3 months following effectiveness of the rule filing. Phase II immediately follows Phase I and runs for 6 months. The proposal specifically provides for the real-time dissemination of trade reports to begin at the start of Phase I for bonds with \$1 billion initial issuance and for the 50 high yield bonds currently quoted in the Fixed Income Pricing System ("FIPS"). The NASD will develop dissemination rules and protocols for other bonds during Phases I and II, based in part on further study of the impact on market liquidity of increased transparency.

Obligations Regarding TRACE Data. NASD will collect and disseminate market information appropriately and make such information available on terms that are fair and reasonable. The NASD recognizes that it must meet all of the obligations imposed under the Securities

³ NASD staff believes that dual reporting would satisfy its audit trail quality concerns, and would support dual reporting if it is determined that dual reporting is a less burdensome alternative.

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Exchange Act of 1934 ("Exchange Act"), including capacity, redundancy, audit trail, and surveillance capabilities. In response to specific concerns raised about Nasdaq's role, Nasdaq will not possess any ownership rights in TRACE data, and will not exercise any decision-making authority over the TRACE project.

Implementation Schedule. To address potential operational concerns, the NASD has requested to begin Phase I of TRACE 180 days following the SEC's approval of the service. The additional time will allow NASD members and vendors to prepare for trade reporting and dissemination and give the NASD sufficient time to more fully test the TRACE technology.

T + 1 Clearance and Settlement Issues. Many commenters raised operational and competitive concerns about how TRACE fits operationally with industry initiatives to facilitate a T + 1 clearance and settlement cycle, and later, straight-through processing (STP). The TRACE architecture should provide multiple ways of entering trade reports. With respect to national and international clearing entities and other institutions that may play a role in the clearance and settlement of transactions, the NASD is committed to the interoperability of its systems with others. NASD will ensure that its systems remain flexible and capable of being quickly and efficiently adapted to later developed standards and protocols. NASD does not believe, however, that the pressing need for improved transparency in the fixed income securities markets should be subordinated to the much more complex T + 1 initiative, which is not anticipated to begin until at least 2004.

"Yield" Data Added to Transaction Reports. After additional review of data that is required to monitor the fixed income markets, the NASD amended the reporting requirements of Rule 6230(c) to require that yield be reported as one of the elements of a transaction report. The addition of a yield value, determined in conformity with Rule 10b-10 under the Exchange Act, provides a valuable mechanism to match, verify, and analyze pricing of corporate bonds. Such data will enable the NASD to identify potentially erroneous fixed income transactions on a real time basis, thereby promoting the integrity of the transaction reports. Since firms already are required to provide this information to customers as part of the transaction confirmation process, this reporting requirement should not impose a meaningful additional burden.

In closing I would like to reiterate the commitment of the NASD to the goal of greater corporate bond transparency. We believe that the current proposal makes that goal achievable in the very near future. Finally, I would like to thank you and your staff for their continued efforts in this area. If I can be of further assistance, please call me, or Mary Schapiro, at 202-728-8140.

Sincerely yours,



Robert R. Glauber
Chief Executive Officer and President
National Association of Securities Dealers, Inc.

Enclosure