

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49086; File No. SR-NASD-2003-157]

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

January 15, 2004.

#### I. Introduction

On October 14, 2003, 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")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend NASD Rule 7010(k) relating to fees for the Trade Reporting and Compliance Engine ("TRACE") prior to the expiration of the pilot program for fees on January 31, 2004 and seeking permanent approval of the fee structure. NASD amended the proposed rule change on October 22, 2003.<sup>3</sup> Notice of the proposed rule change and Amendment No. 1 thereto, including a discussion of the proposal in greater detail, was published for comment in the **Federal Register** on November 4, 2003.<sup>4</sup> The Commission received two comment letters regarding the proposal.<sup>5</sup>

On December 30, 2003, NASD filed Amendment No. 2 to the proposed rule change and a response to the two

comment letters.<sup>6</sup> This order approves the proposed rule change, as amended by Amendment No. 1, accelerates approval of Amendment No. 2, and solicits comments from interested persons on Amendment No. 2.

#### II. Discussion

After careful consideration, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations promulgated thereunder applicable to a registered securities association and, in particular, with the requirements of section 15A(b)(6) of the Act.<sup>7</sup> Specifically, the Commission finds that approval of the proposed rule change is consistent with section 15A(b)(6) of the Act in that it is 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.<sup>8</sup> In addition, the Commission finds that approval of the proposed rule change is consistent with section 15A(b)(5) of the Act,<sup>9</sup> which requires, among other things, that NASD's rules provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system that NASD operates or controls.

TRACE became effective on July 1, 2002.<sup>10</sup> Fees proposed by NASD for participants and users of the TRACE facility were originally approved by the Commission on June 28, 2002 on a six-month pilot basis.<sup>11</sup> The pilot program was modified and extended in four

subsequent rule filings until January 31, 2004.<sup>12</sup> During the pilot period, NASD has revisited concerns expressed at the time of the approval of the initial pilot regarding whether the TRACE fees satisfy the statutory standards regarding equitable allocation, unfair discrimination, and reasonableness. NASD has adjusted the TRACE fees based upon its experience during the pilot period in an effort to make the initial fee structure more fair and reasonable.<sup>13</sup> The Commission believes that the fees allow users flexibility in how they will interact with the system, and are scaled according to objective criteria applied across-the-board to all categories of users. Accordingly, the Commission finds that the TRACE fees satisfy the statutory standards regarding equitable allocation, unfair discrimination and reasonableness.

As previously noted, the Commission received two comment letters, from TBMA and Advantage Data, on the proposed rule change.<sup>14</sup> TBMA's Comment Letter stated that NASD has failed to establish that (i) the developmental and operating costs for TRACE, and therefore the fee structure that supports those costs, are reasonable; and (ii) the fees equitably allocate the expenses among TRACE users.

NASD represented in its response to TBMA's Letter that for the first twelve months of operation (period ending June 30, 2003), TRACE generated revenues of approximately \$12.4 million reflecting approximately \$2.0 million, \$8.9 million, and \$1.5 million for System Fees, Transaction Reporting Fees, and Market Data Fees, respectively, and that aggregate revenue was 70 percent higher than had been estimated in the pre-launch 2002 forecast. NASD also represented that for the first twelve months of operation (period ending June 30, 2003), TRACE expenses were approximately \$12.4 million. This was comprised of \$9.8 million in operating expenses plus an accrual for the recovery of original investment of \$2.6 million (based on a four-year recovery of the investment and an appropriate cost of capital). NASD also represented that there was an 11 percent or \$800 thousand increase in the investment costs over the pre-launch 2002 forecast (from an estimated \$7.2 million to an actual of \$8.0 million), and that operating expenses were 60 percent higher than the pre-launch 2002 forecast.

NASD stated in its response that levels of trade reporting activity have been 82 percent higher than anticipated

<sup>6</sup> See letter from Marc Menchel, Executive Vice President, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, SEC, dated December 29, 2003 ("Amendment No. 2"). Amendment No. 2 amends the proposed rule change to provide that the proposed BTDS Professional Delayed-Time Data Display Fee will operate as a nine-month pilot program.

<sup>7</sup> 15 U.S.C. 78o-3(b)(6).

<sup>8</sup> In approving this proposed rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>9</sup> 15 U.S.C. 78o-3(b)(5).

<sup>10</sup> See Securities Exchange Act Release No. 46144 (June 28, 2002), 67 FR 44907 (July 5, 2002) (File No. SR-NASD-2002-46).

<sup>11</sup> See Securities Exchange Act Release No. 46145 (June 28, 2002), 67 FR 44911 (July 5, 2002) (File No. SR-NASD-2002-63).

<sup>12</sup> See Securities Exchange Act Release No. 46893 (November 22, 2002), 67 FR 72008 (December 3, 2002) (File No. SR-NASD-2002-167); Securities Exchange Act Release No. 47056 (December 19, 2002), 67 FR 79205 (December 27, 2002) (File No. SR-NASD-2002-176); Securities Exchange Act Release No. 47444 (March 4, 2003), 68 FR 11602 (March 11, 2003) (File No. SR-NASD-2003-25); and Securities Exchange Act Release No. 48110 (June 30, 2003), 68 FR 40315 (July 7, 2003) (File No. SR-NASD-2003-97).

<sup>13</sup> *Id.*

<sup>14</sup> See *supra*, note 5.

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

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

<sup>3</sup> See letter from Kosha K. Dalal, Assistant General Counsel, NASD, to Katharine A. England, Assistant Director, Division of Market Regulation, SEC, dated October 22, 2003 ("Amendment No. 1"). Amendment No. 1 makes certain technical corrections and deletes the phrase "(including in some cases members)" in describing the proposed rule text providing that certain summary market information of Delayed-Time TRACE transaction data may be published or distributed by newspapers, press associations, newsletters, or similar media sources without charge.

<sup>4</sup> Securities Exchange Act Release No. 48714 (October 29, 2003), 68 FR 62483.

<sup>5</sup> See letter from Michele C. David, Vice President and Assistant General Counsel, The Bond Market Association ("TBMA"), to Jonathan G. Katz, Secretary, SEC, dated November 25, 2003 ("TBMA's Letter") and letter from Rene L. Robert, President and CEO, Advantage Data, Inc. ("Advantage Data"), to Secretary, SEC, dated November 20, 2003 ("Advantage Data's Letter").

in the pre-launch 2002 forecast prepared by NASD, with TRACE currently processing approximately 28,000 trades per day. In addition, NASD represents that approximately 1,900 NASD member firms have registered for TRACE reporting, over 29,000 corporate debt issues are subject to TRACE reporting requirements, and approximately 4,900 corporate bonds are eligible for dissemination. In addition, NASD stated that the service needs of participants and media have been significantly greater than NASD anticipated.

TBMA's Letter also stated that broker-dealers have an economic interest in net revenues from the sale of TRACE data, that net revenues from the sale of TRACE data should be shared with broker-dealers and that NASD should not make a profit on the system and reporting fees of TRACE. NASD represented in its response that it is a not-for-profit association, owned by its members and dedicated to focusing on its primary mission of regulating markets and members. NASD stated that it has no profit motivation in operating TRACE.

NASD stated that it believes the proposed fees for TRACE are reasonable and non-discriminatory. Further, NASD believes the proposed fees have been reasonably allocated, based on total TRACE revenues annually. This allocation is based on NASD's costs to develop and operate the system, maintain the system and database, and engage in oversight of the fixed income market.

During the pilot period, NASD submitted four rule filings with the SEC to reduce both Transaction Reporting Fees and System Fees to reflect actual usage of the new system. The Commission believes that NASD has adequately addressed TBMA's concerns regarding whether the TRACE fees satisfy the statutory standards regarding equitable allocation, unfair discrimination, and reasonableness.<sup>15</sup> Moreover, NASD has agreed to continue to assess the TRACE fee structure to ensure that the fees remain reasonable.

Advantage Data's Letter questions the appropriateness of charging fees for TRACE transaction data delayed by four hours. NASD stated in its response that professional participants in the TRACE system have stated to NASD staff that Delayed-Time data is valuable to the bond market for pricing thinly traded bonds, spotting trends, and creating derivative products. NASD also

represented that professional subscribers to Real-Time TRACE transaction data will not also be charged for Delayed-Time data. In addition, NASD stated that it continues to provide Real-Time TRACE transaction data to non-professionals for \$1.00 per month, per user ID. NASD represented that Delayed-Time TRACE transaction data will continue to be provided at no charge to non-professionals and professionals will continue not to be charged for delayed data that is received after 11:59 p.m. Eastern Time of the same calendar day in which the transactions are reported and disseminated.

NASD believes that the proposed BTDS Professional Delayed-Time Data Display Fee leads to a more equitable allocation of market data fees among TRACE participants and that members who use Delayed-Time TRACE transaction data should bear some costs for the TRACE system. Amendment No. 2 provides that the TRACE BTDS Professional Delayed-Time Data Display Fee, which has not previously been charged, will operate as a nine-month pilot to enable the Commission to revisit issues relating to consistency with the Act at the end of that period.

Advantage Data's Letter also raised concerns about NASD's mandated use of CUSIP data in TRACE reporting, the ongoing review of NASDAQ's management of TRACE, delays in disseminating TRACE information and the ownership of data derived by NASD. As noted by NASD in its response, NASD has addressed those concerns in prior rule filings and the issues have been addressed in prior approval orders.<sup>16</sup> In addition, this proposed rule change does not address those issues. The Commission expects to continue its review of NASD's operation of TRACE in the context of future proposed rule filings filed by NASD as well as the Commission's ongoing oversight of NASD as a self-regulatory organization.

### III. Accelerated Approval of Amendment No. 2

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. 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 2 responds to

comments and provides that the TRACE BTDS Professional Delayed-Time Data Display Fee will operate as a nine-month pilot program.<sup>17</sup> Conversion of the TRACE BTDS Professional Delayed-Time Data Display Fee to a pilot program will enable the Commission to re-evaluate issues relating to consistency with the Act at the end of the pilot program and recommend any needed changes to NASD at the end of that time.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 2, including whether Amendment No. 2 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. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-NASD-2003-157. This file number should be included on the subject line if e-mail is used. To help the Commission process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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 NASD. All submissions should refer to file number SR-NASD-2003-157 and should be submitted by February 13, 2004.

### V. 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,<sup>18</sup> that the

<sup>15</sup> NASD also provided the Commission's Division of Market Regulation with additional information in response to questions raised by the Division's staff.

<sup>16</sup> See Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131 (January 29, 2001), (File No. SR-NASD-99-65); and Securities Exchange Act Release No. 47302 (January 31, 2003), 68 FR 6233 (February 6, 2003), (File No. SR-NASD-2002-174).

<sup>17</sup> This pilot will begin February 1, 2004 and end on October 31, 2004. See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, SEC, dated January 15, 2004.

<sup>18</sup> *Id.*

proposed rule change (SR-NASD-2003-157), as amended by Amendment No. 1 and hereby is approved, and Amendment No. 2 is approved on an accelerated basis.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49094; File No. SR-NSCC-2003-05]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of a Proposed Rule Change Permitting Elimination of All Hard Copies of Important Notices

January 16, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on March 14, 2003, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The proposed rule change would amend NSCC's rules and procedures to provide that notices sent in electronic format meet NSCC's notification obligations.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NSCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NSCC has prepared summaries, set forth in sections (A), (B),

and (C) below, of the most significant aspects of such statements.<sup>2</sup>

#### (A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

NSCC currently distributes notices in a hard copy form via U.S. mail to members outside of the New York area, to the Direct Drop Boxes of each member with a New York presence, and via fax when necessary. The proposed rule change would modify NSCC's Rule 45 to allow NSCC to post notices on its Web site and to have these postings satisfy NSCC's notification obligations. The rule change would require members to access that Web site throughout the day.

NSCC believes that the proposed rule change would facilitate the timely dissemination of information necessary for participation in NSCC and therefore is consistent with the requirements of the Act and the rules and regulations thereunder.

#### (B) Self-Regulatory Organization's Statement on Burden on Competition

NSCC does not believe that the proposed rule change would have an impact on or impose a burden on competition.

#### (C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments relating to the proposed rule change have been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

#### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within thirty five days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (a) By order approve the proposed rule change or
- (b) Institute proceedings to determine whether the proposed rule change should be disapproved.

#### VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and

arguments concerning the foregoing, including whether the proposed rule change 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. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-NSCC-2003-05. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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 Section, 450 Fifth Street NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of NSCC and on NSCC's Web site at [www.nsc.com/legal/](http://www.nsc.com/legal/). All submissions should refer to the File No. SR-NSCC-2003-05 and should be submitted by February 13, 2004.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>3</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49093; File No. SR-NYSE-99-12]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the New York Stock Exchange, Inc. To Amend Exchange Rule 350 ("Compensation or Gratuities to Employees of Others")

January 16, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934

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

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

<sup>2</sup> The Commission has modified parts of these statements.

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