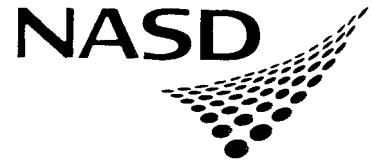


Robert R. Glauber
Chairman and Chief Executive Officer

JAN 07 2004

December 31, 2003



The Honorable W.J. "Billy" Tauzin
Chairman
Committee on Energy and Commerce
U.S. House of Representatives
2328 Rayburn House Office Building
Washington, DC 20515

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

Dear Congressmen Tauzin and Dingell:

In this, the final annual status report called for by the Energy and Commerce Committee on the progress of the corporate bond transparency initiative mandated by the Securities and Exchange Commission ("SEC"), NASD is pleased to report that the Trade Reporting and Compliance Engine, referred to as TRACE, has experienced considerable growth over 2003 and continues to increase transparency in the U.S. corporate bond markets to the benefit of the investing public and other market participants.

TRACE Impact

Launched on July 1, 2002, TRACE enables investors to receive accurate information on the actual sale price of U.S. corporate bonds. As with the disclosure of the actual selling price of equities, this capability affords a new level of protection to bond investors who now have access to independent bond transaction data that can be used to confirm that they are getting a fair market price when they are buying or selling bonds. Because TRACE makes important price information public and accessible, it increases market fairness and integrity.

TRACE also enables NASD to create an audit trail and surveil the U.S. corporate bond markets. Currently, over 29,000 corporate debt securities are subject to TRACE reporting requirements. NASD members that are a party to a secondary "over-the-counter" market transaction in a TRACE eligible security have a reporting obligation under TRACE. With this improved availability of market information, NASD has been

able to assess the overall market dynamics. For example, the marketplace is far more active than originally anticipated. On a typical day approximately \$20 billion of corporate bonds “turn over” in approximately 28,000 transactions. In addition, contrary to conventional wisdom, TRACE statistics reveal that this is not overwhelmingly an institutional market with little “odd-lot” (i.e. retail) activity. In fact, approximately 65% of the TRACE transactions are in quantities of less than 100 bonds or \$100,000 in par value. As a result of TRACE, aggregate corporate bond activity and statistics are available to monitor trading patterns and volumes of market participants and are now being made available to market participants and investors alike.

Increased Dissemination

At the commencement of 2003, Phase I dissemination was in place and approximately 550 bonds were subject to dissemination and trading information was made available to the public. Phase I dissemination was limited to those Investment Grade (single A rated or higher) TRACE-eligible securities having an original issue size of \$1 billion or greater, and 50 representative high yield bonds carried over from the NASD’s Fixed Income Pricing System (“FIPS”).

Following the SEC’s February 2003 approval of NASD’s plans to increase dissemination, NASD implemented Phase II on March 3, 2003. Under Phase II, NASD began disseminating transaction information on all Investment Grade bonds with an original issue size of \$100 million or more that are rated at least A3/A-. (NASD also continued to disseminate the two classes of bonds subject to dissemination since July 1, 2002.) This initiative increased the number of disseminated bonds from the original 550 bonds to approximately 4,200 bonds.

In April 2003, NASD began the dissemination of 120 “triple-B”-rated TRACE-eligible corporate bonds as part of a study to determine the effects of dissemination in these lower rated bonds. The 120 bonds represent a broad spectrum of “triple-B” rated bonds. Unlike previous dissemination criteria, these securities will remain disseminated regardless of any change in rating, including any downgrade to high yield.

With the implementation of Phase II dissemination and the “triple B” bonds, NASD had expanded the pool of disseminated TRACE-eligible securities from the original 550 to approximately 4,400 by the end of April 2003. Under these new dissemination criteria, as of December 2003 NASD disseminates transaction information on approximately 4,900 TRACE-eligible securities to the investing public and other market participants which represent approximately 70% percent of the investment grade par value traded in the overall market.

This increase in dissemination of corporate bond information continues the NASD’s efforts to put more information in the hands of investors and other market participants. In a very short period of time, TRACE has provided a level of information that has brought unprecedented transparency to the corporate bond market. NASD will continue to work with the SEC and the industry to sustain this trend.

Improvements in Timeliness

Another key development in 2003, was the compression of the reporting time to 45 minutes from 75 minutes. The SEC approved the 45-minute reporting requirement on June 18, 2003, which took effect on October 1, 2003. Under the rules as amended, a member must report a transaction in a TRACE-eligible security within 45 minutes of the time of execution. Reducing the reporting period, which results in the market receiving market-based pricing information more quickly, has been an important regulatory goal to further enhance the transparency of the debt market. NASD staff intends to recommend a further reduction(s) of the TRACE reporting period until we reach the accepted standard for real time reporting of 15 minutes.

Bond Transaction Reporting Committee

As reported in our letter last year, the Bond Transaction Reporting Committee (“BTRC”) was formed in 2001 for the purpose of advising the NASD Board on issues related to transparency in the bond markets. The Committee is comprised of ten members who represent both broker-dealers and institutional investors. Five members were recommended to the NASD Board by NASD staff and five by The Bond Market Association.

NASD has been working with the BTRC to develop parameters and timeframes for expanding the current universe of bonds subject to dissemination (“Phase III”). As of this writing, the full BTRC has met 9 times in 2003 with NASD to discuss dissemination issues and work towards recommendations for Phase III. As part of NASD’s and the BTRC’s information gathering process, the NASD commissioned an independent liquidity study to analyze the effect that the dissemination of price and other information in certain TRACE-eligible securities transactions has upon the liquidity of those markets. The NASD expects to receive the completed studies in early 2004. Based on these studies and other pertinent information, the BTRC plans to make recommendations to the NASD Board regarding Phase III dissemination.

Educational Effort

In July, NASD fulfilled its obligation to deliver an educational piece on the bond market on its public site. NASD decided to work with the Bond Market Association in this effort and linked the NASD’s BondInfo site to BMA’s www.investinginbonds.com site. This increased level of information for investors is another step in fulfilling NASD's commitment to make pricing more transparent, and the bond market easier to access and utilize.

Further, the NASD offered a number of programs to educate member firms regarding TRACE and regulation of the corporate bond market. In addition, in 2004, NASD is planning several E-Learning initiatives as well as a one-day fixed income conference.

TRACE continues to be an increasingly important tool to monitor the corporate debt market, to protect all investors, and to ensure market integrity. TRACE provides important information and has proven to be an excellent vehicle for meeting the goal we share with the SEC and the securities industry, to increase access by the public and professionals alike to vital bond market data. We will continue to work to expand dissemination and increase the availability of data as part of our mission to ensure market integrity.

I would again personally like to thank you, your staff, and the other members of the Committee for the continued effort to better inform and protect the investing public and all market participants. If I can be of further assistance, please do not hesitate to call.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert R. Glauber". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Robert R. Glauber

cc: The Honorable Michael G. Oxley, Chairman
Committee on Financial Services

The Honorable Barney Frank, Ranking Member
Committee on Financial Services

The Honorable William Donaldson, Chairman
Securities and Exchange Commission