

February 10, 2000

Jonathan G. Katz, Secretary
Securities & Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: File No. SR-NASD-99-65; NASD "TRACE" Proposal

Dear Mr. Katz:

The Fixed Income Transparency Subcommittee of SIA's Operations Committee (the "subcommittee") is pleased to offer its comments in response to the above referenced rule filing. The subcommittee is composed of operations professionals at SIA member firms and utilities and the comments included herein are limited to the practical considerations of implementing the proposed system, including programming, training, testing, and the likely effect of the proposed system on the evolving structure for trade processing.

The subcommittee supports the overall goal of greater transparency in the fixed income security markets. If TRACE is scaled back to function as a price reporting service that is compatible with the existing infrastructure for processing trades, the proposal presents fewer concerns. However, to the degree the proposed system is intended to have a larger scope, inclusive of trade matching and comparison, the subcommittee has four principal objections. First, the proposed timeline is unrealistic in that it assumes implementation can be accomplished in between such major initiatives as Y2K, decimal conversion, OATS and industry capacity build-out. Second, the proposal seeks to "layer" a proprietary system on top of (and, in some respects, in place of) an existing complex infrastructure for the processing of fixed-income transactions, without a more studied regard to its effect on risk, efficiency or compatibility with other critical processes. Third, the design of the proposed system does not contemplate the future inclusion of non-TRACE eligible securities, which is critical to avoid the inefficiency of separate systems for individual products. Finally, the subcommittee is very concerned that granting any one entity, including the NASD, an exclusive franchise in trade reporting or processing will stifle competition and innovation in the market for post-trade processing and force firms to conform all existing technology infrastructure to a proprietary rather than an open standard.

1. Impractical Implementation Timing

As the Commission recognized when it passed the Y2K moratorium on new rules requiring system changes, the Y2K effort required a major commitment on the part of systems and operations personnel at our member firms. It is for that reason that new initiatives such as decimal conversion and OATS (Phase III) were scheduled when they were to give firms reasonable timeframes to prioritize and implement their technology requirements. Likewise, in a May, 1999 letter to NASD Chairman Frank Zarb regarding extended trading hours, the SIA urged the NASD, the SEC and Congress to work with the industry to prioritize new initiatives, warning that a failure to do so would cause system failures and hurt investors.¹ Lastly, non-regulatory initiatives, including capacity build-out and system upgrades, need to be addressed to cope with unprecedented increases in market volumes. Given this already crowded calendar for backoffice processing changes, the Subcommittee does not believe it would be prudent to introduce a new trade reporting/processing system until after these preexisting projects are complete.

Furthermore, even if the calendar were not already full of pending projects, the proposal does not provide adequate time for the normal preparatory efforts that would be expected for an undertaking of this size. For example, from the time that acceptable specifications are delivered to users, there must be sufficient time allotted for systems reconfiguration, resolution of all interface issues, training of personnel, and testing. In the case of high volume processing for larger firms, this is a necessity. Also, many smaller firms that specialize in bonds have no Nasdaq-type "computer-to-computer-interface" ("CTCI") connectivity and will have to build an automated solution from scratch if manual input into TRACE proves impractical. Experience has shown that forcing a hasty timetable that does not recognize these essential factors increases the likelihood of confusion, operational disruption, market risk and compliance problems, all of which will in turn require additional time and money to resolve.

Finally, the timetable envisioned for the transparency effort must take into account the timetable envisioned for the planned changes to the settlement cycle. As proposed, the TRACE system extends beyond the scope of price reporting and dissemination, to cover processing functions more relevant to clearance and settlement. Given that the entire industry, including parties which currently provide related processing functions, are working together across all markets and products toward a goal of T+1, it seems plainly incongruous for one service provider in an interdependent market to pursue any timetable outside of this collaborative effort.

¹ See letter dated May 21, 1999, from Marc Lackritz, President, SIA, to Frank Zarb, Chairman, and Richard Ketchum, President, National Association of Securities Dealers, Inc.

2. Risk, Efficiency and Compatibility

The subcommittee believes TRACE would disrupt the current system for the processing and settlement of corporate fixed income securities trades. The existing infrastructure for the processing and settlement of trades across all fixed income products has evolved over several decades, with a great deal of input from operations, compliance, trading and systems professionals at member firms, industry utilities and third party technology systems providers. Utilities and other service providers, such as NSCC/DTC, Thompson, Cedel, Euroclear, and BMA have responded to the needs of the marketplace by developing facilities capable of taking trade data from vastly different industry participant systems and then performing comparison, matching, reporting, and clearance and settlement functions. Firms benefit from the efficiencies that such a network of systems offers both in terms of cost and deployment of resources. More significantly, overall risk is reduced by the prompt and accurate settlements that result.

The subcommittee members have grave concerns that TRACE, however well intentioned its transparency goals are, would disrupt this existing infrastructure. It is imperative that TRACE, or any other reporting system devised, be compatible with the current network of systems which already handles clearance and settlement functions that are arguably more critical than trade dissemination. For example, if trade data must first be sent to TRACE, instead of to a utility for clearance and settlement, as it is today, then prompt payment and resolution of trade discrepancies will be less assured. This settlement risk will be further exacerbated, and thus prove more costly, as the industry moves toward next day settlement. Systemic risk is also a real concern as evidenced by the industry's deliberate efforts in its T+1 analyses to reduce the number of data formats, input points and transmission methods between organizations. The Subcommittee notes that TRACE's trade processing functions, while similar to Nasdaq's ACT system for equities, was developed outside of the T+1 standardization effort within the industry.

3. Product Design Flexibility

We would clearly prefer TRACE to be offered as one option for trade reporting and not as a mandated solution for clearance and settlement processing tasks. Any transparency solution that is offered to the marketplace should be sufficiently flexible to accommodate the reporting of products not currently covered by TRACE as well as products that may become subject to reporting in the future. At this time, TRACE is designed to handle corporate bonds only. Thus, in order to participate in future transparency initiatives involving other fixed income products, a firm will have to invest in additional systems and interfaces.

Furthermore, the subcommittee notes that TRACE does not provide for the reporting of certain data elements. Some data elements, such as accrued interest and settlement date, that are not necessary for transparency purposes, are nevertheless critical

to clearance and settlement. The industry is supportive of new initiatives to improve processing but their design must be flexible, scalable, and cost-effective, especially if the solution is intended to address a core competency (transparency) for the industry. This principle should apply to any new initiative that is processing-sensitive in nature, whether it's a regulatory proposal or a new service offered to the industry.

At a minimum, the TRACE system should be designed to accommodate all relevant data fields for all fixed income products. We agree with the views expressed by the Regional Municipal Operations Association ("RMOA") that information entered once through a common aggregating source for a user should be accessible to the various systems of other solution providers dedicated to transparency, comparison, matching, clearance and settlement. The subcommittee notes that the MSRB accomplishes trade reporting for municipal securities with data culled from data flows for a variety of securities *after* the data has been submitted for clearance and settlement. From an operations standpoint, it is critical to avoid the inefficiency of requiring redundant procedures for individual products and functions.

4. Competition vs. Mandated Solution

In addition to the concern raised about the impact of the TRACE system on the current infrastructure, there is an even greater concern over the willingness and ability of a universal system like TRACE to respond to the processing challenges of tomorrow. Adapting to T+1 and straight-through processing are just two of the challenges that the industry and the regulators are working jointly to address. The marketplace will continue to be challenged by the demands of firms for low cost, highly efficient processing solutions. Granting the NASD an exclusive franchise on any part of the fixed income post-execution processing function will stifle competition and innovation in the market to provide solutions. In addition, forcing firms to adapt to a proprietary rather than an open standard will make existing infrastructure obsolete overnight, costing the industry millions in replacement costs and retraining. Imposing a proprietary solution at the same time the industry is moving to further embrace open standards and open architecture in systems development, would send a confusing message to the public and the industry about the ability of regulation to evolve along with technology.

Given the increased efficiency and reduced risk of the present system, and the need to preserve innovation in order to accomplish both regulatory and business goals in the future, the SEC should consider proposing **standards** of trade reporting, rather than mandate the provider. This way, utilities and other service providers could continue to compete to offer post-trade processing solutions to the marketplace, and firms would be free to work with any solution provider, provided that it could perform trade reporting in the time and manner determined by the SEC. If the NASD is going to add a service for collecting and reporting trades, then it should work with firms and utilities to figure out the best way to integrate this service.

To summarize, we believe price transparency can be achieved using both TRACE and non-TRACE solutions in a timeframe that both the industry and the SEC could support. Regarding the more complex issue of trade submission for clearance and settlement, we recommend that the NASD join the other participants in the existing T+1 planning effort to create a more comprehensive, permanent fixed income processing solution for the industry.

This subcommittee would be willing to work with the NASD and all the other market participants mentioned in this letter to develop a price transparency solution that works for the marketplace as a whole. If we can provide any further information or clarification of the points made in this letter, please contact the undersigned or Scott Kursman, SIA Assistant General Counsel, at 212-618-0508.

Respectfully submitted,

Noland Cheng
Chairman, Fixed Income Transparency
Subcommittee of SIA's Operations Committee

cc: Honorable Arthur Levitt, SEC
Honorable Norman S. Johnson, SEC
Honorable Isaac C. Hunt, Jr., SEC
Honorable Laura S. Unger, SEC
Honorable Paul R. Carey, SEC
Annette Nazareth, SEC
Bob Colby, SEC
Belinda Blaine, SEC
David Sieradzki, SEC
Alden Adkins, NASD
Justin Tubiolo, NASD
Pat Campbell, NASD
Jerome Clair, Chairperson, SIA Operations Committee