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April 27, 1998

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Publication or Submission of Quotations Without Specified
Information - File No. S7-3-98

Dear Mr. Katz:

The Bond Market Association (the "Association")¹ appreciates the opportunity to comment to the Securities and Exchange Commission (the "Commission") on proposed amendments to Rule 15c2-11 under the Securities Exchange Act of 1934 (the "Exchange Act"), as contained in Release No. 34-39670 (February 17, 1998) (the "Proposing Release").

The comments contained in this letter address the proposed amendments, and Rule 15c2-11 in general, solely from the perspective of the fixed-income markets. The Association is not expressing any view as to the application of the Rule, either as currently in effect or as proposed to be amended, to any portion of the equities market.

Rule 15c2-11

Rule 15c2-11 prohibits dealers from publishing quotations for securities on certain "quotation media" (as defined in the rule) unless they have received certain specifically enumerated information about the issuer. The proposed amendments would heighten dealers' obligations with respect to the information, including requiring that they review it prior to publishing quotations and deliver it to anyone who requests it.

In the Proposing Release, the Commission states that it is proposing the amendments to Rule 15c2-11 "in response to increasing incidents of fraud and manipulation in the over-the-counter securities market involving thinly traded securities of thinly-capitalized issuers (i.e., "microcap securities")."² In 1991, in adopting amendments to Rule 15c2-11, the Commission cited its concern "about instances of fraudulent and manipulative conduct involving transactions in low-priced securities, commonly referred to as 'penny stocks'."³ The 1991 amendments were in large part in response to the findings of the Commission's Penny Stock Fraud Task Force. Both the 1991 amendments and the currently proposed amendments were aimed at abuses in a particular segment of the equities market. Throughout its history, market participants have understood the Rule to have been intended to solve problems in the equities markets, not the debt markets. Furthermore, as evidenced by the unavailability of the Rule's exceptions to the debt

markets,⁴ the Association believes that the application of Rule 15c2-11 to these markets was unintended by the Commission and serves no policy objective.

Application of Rule 15c2-11 to the Fixed-Income Markets

Rule 15c2-11, both as it currently exists and as proposed to be amended, regulates dealers in the market for most debt securities⁵ in addition to dealers in the markets for microcap equities and penny stocks which are more clearly the Rule's targets. Most debt securities are traded in the over-the-counter market rather than on NASDAQ or an exchange. Therefore, a rule which imposes requirements on dealers seeking to publish quotations on any securities in the over-the-counter market will seemingly on its face appear to affect dealers in fixed-income securities to the extent that a quotation medium is used.

The fraud and manipulation seen by the Commission in the microcap equity and penny stock markets are not evident in the fixed income market.

The Association believes that the kind of fraud and manipulation which the Commission perceives, and seeks to eliminate, in the microcap securities and penny stock markets are not evident in the fixed-income markets. None of the anecdotal evidence cited by the Commission in the Proposing Release relates to fixed income securities.⁶ The Association believes that the type of manipulative schemes described in the Proposing Release have not been observed in the fixed income market, but rather are concentrated in the microcap and penny stock markets. Indeed, the Association has been unable to find any reference to fixed income securities in any of the material published by the Commission with respect to Rule 15c2-11 in the approximately 18 years since the Rule was first adopted (other than the Proposing Release, which questions the need for the Rule in the debt markets). The National Association of Securities Dealers (NASD) and other commentators discuss the Rule as one related to the over-the-counter stock markets.⁷ Although the Rule seemingly covers quotations with respect to debt securities, they do not appear ever to have been a specific target of the Rule. This impression is confirmed by the fact that the Commission seeks comment in the Proposing Release as to whether some or all debt securities should be exempted from Rule 15c2-11.

The Association believes that a principal reason that the fixed income market is not subject to the same kind of fraud and manipulation identified in the Proposing Release is that the investors in the fixed income market are overwhelmingly institutional.⁸ This is particularly true in the high-yield market, where the surge in issuance under Rule 144A under the Securities Act of 1933 (the "Securities Act") has barred all but the largest institutions from most new issues. The predominantly institutional nature of investors in the debt market contrasts sharply with the predominantly retail nature of investors in the microcap equity market. Institutional investors have a degree of access to issuers, and information about those issuers, that is on a par with, if not higher than, that of dealers. They do not require the same level of protection that the Commission has instituted in

Rule 15c2-11 as do the primarily retail investors in the penny stock and microcap equity markets.

The Association recommends that debt securities be exempted from Rule 15c2-11.

In the Proposing Release, the Commission included Question 45, as to whether the Rule should continue to apply to all debt securities. The Association believes that the Commission should exempt all debt securities from the requirements of Rule 15c2-11. The Commission has not discovered evidence of significant fraud and manipulation of the type sought to be remedied by Rule 15c2-11 in the over-the-counter debt markets. In its recent adoption of Regulation M, the Commission noted that while the prevention of manipulation is a fundamental goal of the federal securities laws, there are "cases where either the risk of manipulation is small or the costs of the restrictions are disproportionate to the purposes they serve."⁹ The same principle should be applied with respect to Rule 15c2-11 as it applies to the debt markets.

Since the debt markets are not purely institutional, the Commission may not agree that all debt securities should be exempt from Rule 15c2-11. Set forth below are alternative measures that could be applied to exempt most debt securities from Rule 15c2-11 while retaining its coverage in areas where the Commission perceives a greater need for investor protection.

Issuers as to which there is substantial information available in the market. At a minimum, we believe that the goals of Rule 15c2-11 are adequately met for all debt securities which are either issued by an issuer which is a reporting issuer under the Exchange Act, or senior to a security which is listed on a national exchange or the NASDAQ National Market System. In either such case, there is sufficient information available to all market participants to allay the Commission's concerns about the fraud and manipulation which can occur in the absence of reliable and readily available information.

Debt securities being resold pursuant to Rule 144A. The Association strongly believes that the protections of Rule 15c2-11 are not needed in cases where debt securities are to be resold pursuant to Rule 144A. There are several reasons for this. First, the qualified institutional buyers (QIBs) which are able to purchase such securities are the very largest institutional investors, which have sophisticated research capabilities of their own and do not rely on dealers for research. In addition, Rule 144A requires that issuers provide certain information, thus ensuring that even an issuer not subject to the reporting requirements of the Exchange Act makes adequate information available to investors and potential investors. Since quotations for resales pursuant to Rule 144A must be made in a manner that ensures that they are accessible only to QIBs, the Commission's investor protection goals in Rule 15c2-11 are unnecessary with respect to such quotations.¹⁰

Investment grade and high-yield debt. In addition, an exemption for investment grade debt would be consistent with the Commission's long-held view that "it is very difficult, if not impossible, to manipulate the price of investment grade debt."¹¹

The Association has in the past pointed out to the Commission the changes in the market for high-yield securities which should, we believe, lead the Commission to conclude that the protections of Rule 15c2-11 are not necessary in that market.¹² In the Reg M Letter, the Association pointed out the sophisticated nature of high-yield market participants;¹³ institutional holders, with their research capabilities, frequently have greater access to issuer information than dealers do. In addition, the Association pointed to the improved transparency and surveillance in the pricing of high-yield securities and the increased level of credit analysis of high-yield securities.¹⁴ The Association believes that these market characteristics should give the Commission sufficient comfort with the high-yield debt market to exempt it from Rule 15c2-11.

Offers made offshore in reliance on Regulation S. Quotations made on quotation media that the dealer reasonably believes to be accessible solely to offshore investors should be exempt from Rule 15c2-11. This should be the case even if, due to circumstances beyond the control of the dealer, the quotations are or subsequently become accessible to investors in the United States.

Mortgage-backed and other asset-backed securities. As with investment grade debt, the Association believes that it would be very difficult, if not impossible, to manipulate the price of mortgage-backed and other asset-backed securities. In general, prices of these securities, the vast majority of which are sold as publicly-registered, investment-grade offerings, are based upon a spread to U.S. Treasury securities of comparable maturities, rather than on the credit quality and business prospects of an issuer operating an ongoing business. Mortgage-backed and asset-backed securities within the same credit rating categories and maturity bands are therefore viewed by investors as broadly fungible and interchangeable, lessening the prospects for price manipulation of any particular security. Although issuers of these securities typically do not maintain their status as reporting companies under the Exchange Act, performance information concerning the collection and distribution of cash flows from the assets underlying the securities—the basic information used for secondary market pricing and valuation—is generally made available throughout the life of the transaction. Finally, the investor base for mortgage-backed and asset-backed securities is overwhelmingly institutional in nature, a factor which, in combination with the others outlined above, should provide the Commission with sufficient comfort to exempt such securities from Rule 15c2-11.

Issuer Information Requirements

Dealers should not be subject to a due diligence obligation in connection with publishing quotations.

Due diligence obligations in connection with the publication of quotations are unprecedented under the federal securities laws. Perhaps the closest analogy to the proposed Rule 15c2-11 requirement is Exchange Act Rule 15c2-12, which was amended in 1994 to require that municipal securities dealers making recommendations to customers have in place procedures to receive current information about municipal securities and issuers. Even in the context of making recommendations, that Rule stops short of requiring that the dealer review the information so received prior to taking any specific action.¹⁵ Publication of a quotation should trigger a lower, not a higher, standard of due diligence than is triggered in connection with the making of a recommendation to a customer. The Association strongly opposes any move by the Commission to impose a due diligence obligation on dealers making quotations.¹⁶

The heightened obligations of dealers with respect to issuer information will expose them to increased liability in connection with publishing quotations, which they may choose to avoid by publishing fewer quotations.

The proposed amendments to Rule 15c2-11 will increase dealers' obligations with respect to issuer information, by requiring them to obtain and review the information prior to publishing quotations. This new obligation will expose the dealer to liability to investors, who will likely seek to recover from the dealer (among others) when a fraud is eventually discovered. It may also expose the dealer to liability to issuers in cases where the dealer makes a judgment that it can no longer publish quotations because it has concerns about a particular issuer, if the dealer's decision significantly reduces liquidity for that issuer's securities. Concern about these dual potential liabilities may drive dealers to substantially limit the securities as to which they are willing to publish quotations. The Association believes that these liability concerns for dealers are not offset by any substantial benefit to investors from having dealers review issuer disclosure.

Dealers should not be required to confirm that an issuer is current with respect to all of its Exchange Act reporting obligations.

Proposed Section (d)(3) of Rule 15c2-11 would permit dealers to rely on an issuer's Exchange Act reports, but only so long as the issuer is current in its filings. Dealers should be entitled to rely on Exchange Act reports appearing on the Commission's EDGAR system so long as all required Forms 10-K and 10-Q have been filed, without the necessity to confirm that the issuer is current with respect to its other Exchange Act reporting obligations. In some circumstances the dealer could not know whether the issuer is fully current without asking the issuer directly. For example, issuers are required to file Form 8-K under the Exchange Act to report special, in many cases unanticipated, occurrences. The failure to timely file a Form 8-K as to such occurrences would not necessarily be a fact that could be determined independently by a dealer. Since there is the possibility at any time that an unanticipated event has occurred but not yet been

reported, the dealer is placed in the position of being required to confirm current reporting with the issuer each time it wishes to publish a quotation. This is an unreasonable burden to place on a dealer in connection with the publication of a quotation.

Information provided pursuant to Rule 144A should satisfy the Rule's information requirements.

Subsections (d) and (e) of the Rule as proposed list the different types of information that a dealer may obtain in order to satisfy the Rule's requirements. The Association believes that the list should include information which the issuer has undertaken to provide, and has in fact provided, under Rule 144A. This information is similar to the information required under proposed Rule 15c2-11 (d), but may not be identical in all cases. This is the information which the Commission has determined to be needed by investors in the 144A market generally, and it should suffice for those investors for purposes of Rule 15c2-11 as well.

Dealers should not be obligated to provide issuer information free of charge.

Subsection (j) of the Rule as proposed would require the dealer to make the requisite information promptly available to anyone who requests it. This obligation is not limited to customers or to persons who actually receive the published quotation. Dealers should not bear the cost of delivering the issuer's disclosure. The Association believes that if the requisite information is available on the Commission's EDGAR system, the dealer should have no obligation to deliver it to anyone. Where the information is not available on the EDGAR system, the Association believes that the dealer should be required to deliver the information only to those with whom the dealer has a customer relationship, and in any event should be entitled to recover its reasonable expenses incurred in providing the information to those who request it.

* * *

As evidenced by the unavailability of the Rule's exceptions to the debt markets, the Association believes that the application of Rule 15c2-11 to these markets was unintended by the Commission and is impractical and unfair. As evidenced by the regulatory concerns underlying the Rule's adoption and subsequent amendments, and the practical application of the Rule, the Association believes that no regulatory purpose is served by applying Rule 15c2-11 to the debt markets.

The Association appreciates this opportunity to provide its views to the Commission. Please address any questions or requests for additional information to Sam Scott Miller of

Orrick, Herrington & Sutcliffe, special counsel to the Association (212.506.5130), or to the undersigned (212.440.9407.)

Very truly yours,

SARAH M. STARKWEATHER
Vice President and Associate General Counsel

cc: The Honorable Arthur Levitt, Chairman, Securities and Exchange Commission
Belinda Blaine, Counsel to the Chairman
The Honorable Paul Carey, Commissioner
The Honorable Isaac C. Hunt, Jr., Commissioner
The Honorable Norman S. Johnson, Commissioner
The Honorable Laura S. Unger, Commissioner
Dr. Richard R. Lindsey, Director, Division of Market Regulation
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John M. Ramsay, Deputy General Counsel, NASD Regulation, Inc.

Corporate Bond Division of the Association:
Executive Committee
High-Yield Debt Committee
Legal Advisory Working Group
Select Association Staff

FOOTNOTES

1 The Association is the bond market trade association, representing approximately 200 securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. More information about the Association is available on its Internet home page at <http://www.bondmarkets.com>. This letter was prepared in consultation with the Executive Committee, the High Yield Debt Committee and the Legal Advisory Working Group of the Association's Corporate Bond Division.

2 Proposing Release at page 9661 of the Federal Register version.

3 Release No. 34-29094 (April 17, 1991), at 81,424 of the CCH version.

4 For example, very few debt securities are listed on NASDAQ or an exchange. Indeed, the New York Stock exchange has recently filed a proposed rule change with the Commission which would terminate the Exchange's bond trading floor as of June 1, 1998. The Wall Street Letter, in reporting on this development (April 13, 1998), states that while the exchange was initially established for bond trading, "as the financial markets matured, however, most bond trading was transferred to the over-the-counter dealer market that dominates today," thus rendering the bond floor obsolete.

5 For purposes of this letter, references to "debt securities" include non-convertible preferred stock and asset-backed securities, except where the context otherwise requires.

6 See Litigation Release No. 15595 (December 18, 1997), cited in footnote 4 of the Proposing Release. The release announces the filing by the Commission of five enforcement actions, involving 58 defendants, in connection with manipulative activities in the microcap equity and penny stock market. Each enforcement action focuses on transactions involving the sale of stock to retail customers.

7 In Notice to Members 92-50, for example, the NASD described the Rule as one that "governs the submission and publication of quotations by brokers and dealers for certain non-NASDAQ over-the-counter equity securities". See also Louis Loss and Joel Seligman, *Securities Regulation* (3d. ed. 1990), at 2579 and 3416.

8 The Association estimates that as of March 31, 1998, less than 5% of the \$2.5 trillion of corporate debt securities outstanding were held by individuals.

9 Release No. 33-7375 (December 20, 1996), 62 Federal Register 520 at 520.

10 We also note that NASD Rule 6710 ("Reporting Transactions in Non-NASDAQ Securities") defines "quotation medium" using the same words as current subsection (e)(1) of Rule 15c2-11, except that it excludes PORTAL, the market system for restricted securities including those eligible for resale pursuant to Rule 144A. Therefore, NASD Rule 6740, which requires among other things evidence that the dealer has complied with Rule 15c2-11, does not apply to PORTAL quotations in securities to be resold pursuant to Rule 144A. This implies that the NASD believes that Rule 15c2-11 either does not apply or is not necessary in the case of Rule 144A resales.

11 Release No. 34-18528 (March 16, 1982), 47 Federal Register 11482 (citing American Telephone & Telegraph Company, SEC No-Action Letter (February 26, 1975)).

12 See Letter from Paul Saltzman, Senior Vice President and General Counsel, and Sarah M. Starkweather, Vice President and Associate General Counsel, of The Bond Market Association, to Jonathan G. Katz, Secretary of the Commission, dated July 17, 1996 (the "Reg M Letter"), in response to the Commission's proposal of Regulation M (Release No. 34-37094 (April 11, 1996)).

13 In the Reg M Letter, we referred to estimates by Capital Access Corporation (a consulting, market research and data resources company serving the fixed income market) that the total high yield debt market at year end 1995 was \$300 billion, and that approximately \$265 billion, or 88%, of the market at that time was held by insurance companies, mutual funds and public pension funds. Although more recent figures are not available, the Association believes that the proportion of outstanding high yield debt held by such institutions has increased significantly since 1995 because of the prevalence of issuance since that time in reliance on Rule 144A. For example, the Association estimates that in 1997, of the \$120.6 billion in new high yield issuance, \$93.8 billion, or approximately 78%, was issued in reliance on Rule 144A.

14 Those arguments, made in the context of the Commission's re-evaluation of the need to apply the restrictions of Regulation M to the high yield debt, may be more persuasive to the Commission in the context of Rule 152-11, given the different purpose of the Rule as compared to the purposes of Regulation M.

15 See Questions and Answers Relating to Material Event Disclosure Under Rule 15c2-12, published in January 1996 by the Association (then known as the Public Securities Association). Question 6 and the response thereto indicate that no specific review requirement is imposed, although rules of the Municipal Securities Rulemaking Board require that the dealer have a "reasonable basis" for recommendations made to customers.

16 This is particularly inappropriate in those instances where regulations require dealers to post quotations. See, e.g., Rule 6230(b)(1) of the National Association of Securities Dealers, Inc. (relating to the Fixed Income Pricing System (FIPS) for trading in high-yield bonds), which requires "FIPS dealers" (as defined) to post quotations in FIPS securities in which they are actively trading.