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December 20, 2000

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

Re: Amendment Nos. 2 and 3 to File No. NASD 99-65 Concerning the Creation of a Corporate Bond Trade Reporting and Transaction Dissemination Facility

Dear Mr. Katz:

The Bond Market Association ("Association")¹ appreciates the opportunity to comment on Amendment Nos. 2 and 3 to the proposal by the National Association of Securities Dealers, Inc. ("NASD"), originally published for comment on December 10, 1999, 2 to create a facility for the reporting and dissemination of information concerning corporate bond transactions. The Association is appreciative of the opportunity to engage in an ongoing dialogue with the NASD concerning corporate bond price transparency. In that light, we recognize and commend the NASD's considerable efforts to respond to concerns that were expressed by the Association and other commentators concerning a number of aspects of the NASD's original proposal.

We welcome the revisions made to the NASD's amended proposal and, subject to our review of critical implementation details, broadly support the transparency framework that has now been articulated by the NASD. We believe that the NASD's amended proposal will significantly promote the goal of enhanced transparency in the corporate bond market while taking into account the concerns of the Association's member firms concerning liquidity, governance and operational matters. The Association, however, believes that further revisions to the NASD's amended proposal are required. These revisions are needed first, to clarify the allocation of economic benefits and the manner of distribution of market data resulting from trades in corporate bonds and second, to relieve broker-dealers of a new and burdensome requirement for the reporting of clearing agency information.

I. Executive Summary.

The Association strongly supports those aspects of the NASD's amended proposal that incorporate the following principles:

The phase-in of public dissemination of trade information to take account of liquidity concerns, and the establishment of a joint NASD/industry mechanism to evaluate the liquidity impact of progressively broader dissemination of such information;

The clarification of the respective roles of the NASD, NASD Regulation and Nasdaq;

The rendering of trade comparison as voluntary rather than compulsory in the NASD's price transparency system;

The inclusion of broker-dealers as a substantial voice in the governance of the trade reporting system; and

The recognition of the need for a realistic schedule concerning the starting date for trade reporting.³

The Association advocates further revision⁴ of the NASD's amended proposal to deal with the following issues and concerns:

The need to clearly distinguish between last sale data and historical data;

An explicit recognition of the economic interest of data contributors in the revenue stream produced by the commercialization of last sale and historical data;

The potential role of broker-dealers, through the Association or an entity sponsored by the Association, as the distributor of historical data;

The need to relieve firms of the duplicative and inefficient requirement to report clearing agency information to the NASD; and

The need for clear guidance, substantially before trade reporting commences, relating to implementation matters such as system specifications, costs and fee schedules, and system rules and contracts.

II. The Association Strongly Supports Most Elements of the NASD's Amended Proposal.

With the exception of the issues discussed below in Parts III and IV below, the Association strongly supports the overall approach to corporate bond price transparency that the NASD has adopted in its amended proposal. The framework of the NASD's amended proposal reflects a number of comments and suggestions that the Association made in its comment letter dated February 9, 2000⁵ and that were subsequently

discussed between the Association and the NASD in the months preceding the filing of the NASD's amended proposal. The Association applauds the following positive revisions that have been made to the NASD's original proposal:

A phased-in approach will be taken to public dissemination of trade information in order to take account of liquidity concerns. In response to the Association's recommendation that appropriate safeguards be implemented to avoid potential harm to market liquidity, the NASD has proposed a phased-in approach to public dissemination of corporate bond trade information. As a first step, transaction information will be disseminated immediately concerning trades in investment grade bonds with an original issue size of \$1 billion or more and in high-yield bonds denominated as the "FIPS 50." Subsequently over two phases spanning a nine-month period, the Bond Transaction Reporting Committee ("BTRC") will make recommendations concerning dissemination parameters. 6 These recommendations will first cover 50% by trading volume of investment grade bonds and will thereafter cover all other segments of the corporate bond market, including the balance of investment grade bonds and all high yield bonds.

The NASD has clarified the respective roles of the NASD, NASD Regulation and Nasdaq. The Association raised concerns about conflicts of interest resulting from Nasdaq's role, as originally proposed, as sole provider of trade reporting and comparison services. The NASD has now clarified that the NASD will be the owner of the trade reporting system, that NASD Regulation will perform all regulatory functions associated with the reporting of trades in corporate bonds, and that Nasdaq will provide technology services to the NASD on a contractual basis. 7

The NASD has made trade comparison in its system voluntary rather than mandatory. In the Association's First Comment Letter, the Association raised concerns about the anti-competitive impact that could result from the NASD's designation of its own trade comparison system as the exclusive and regulatorily mandated trade matching system. In addition, the Association pointed out that the creation by the NASD of a compulsory trade comparison system for corporate bonds was not consistent with industry efforts to move to T+1 settlement and straight-through-processing. The NASD now proposes that trade comparison services will be voluntary and that firms will be free to select other entities to compare their transactions in corporate bonds. 8

Broker-dealers will have a substantial voice in the governance of the trade reporting system. The NASD's amended proposal contemplates the creation of the BTRC, which will be responsible for providing "significant input" on issues relating to liquidity impacts and the phase-in of public dissemination of trade information, as well as the setting of fees for distribution of "real-time" data to the public. The BTRC will be composed of eight members, four of whom will be recommended by the Association. 9

The NASD has recognized the need for a realistic schedule concerning the starting date for corporate bond trade reporting. The Association's First Comment Letter noted a

number of practical operational problems with the original time frame contemplated by the NASD for implementation of corporate bond trade reporting. The NASD's amended proposal now explicitly states that the NASD will seek the SEC's approval to begin trade reporting 180 days after SEC approval of the NASD's amended proposal. The Association reiterates that a period of 180 days is the minimum time frame required for firms to take all the steps necessary to implement trade reporting. 10

III. The NASD's Amended Proposal Should Be Further Revised to Clarify Broker-Dealers' Interest in Historical Data and the Revenues Resulting from the Sale of Data, and to Relieve Firms of a New and Burdensome Reporting Requirement.

Although the Association strongly supports the overall framework for corporate bond trade reporting that is set forth in the NASD's amended proposal, the Association believes that several matters require revisions that should be incorporated into the NASD's amended proposal as finally adopted. The Association has two principal concerns in this regard.

The first concern relates to the need clearly to distinguish between "real-time" or last sale data, on the one hand, and historical data, on the other hand. The Association believes that different distribution channels could exist for these two categories of data, thereby underscoring that each category constitutes distinct intellectual property that may be separately licensed. The Association also believes that the final rule should explicitly recognize the economic interests of broker-dealers in both last sale and historical data. 11

The second concern relates to a new and duplicative requirement that the NASD has imposed for firms to submit transaction information that is sent to clearing agencies. This requirement is in addition to the existing requirement to submit a trade report under Rule 6230(c). The Association believes that this new requirement is unnecessarily burdensome and that NASD Regulation's understandable need to assure itself of data integrity could be satisfied by less burdensome means.

A. Historical Data Should be Distinguished from Last Sale Data, and Dealers' Economic Interest in the Revenues and Distribution of Historical Data Should be Explicitly Recognized.

The NASD's amended proposal makes no explicit reference to historical data relating to trades in corporate bonds. The NASD's amended proposal stipulates only that the NASD will register as an exclusive securities information processor ("ESIP") with regard to undefined "information" relating to fixed income transactions.

Discussions between the NASD and the Association that preceded the publication of the NASD's amended proposal resulted in a mutual understanding on several core principles relevant to corporate bond price transparency. One of the critical principles so agreed was that the NASD would recognize the Association's right to disseminate historical trade

information, which the Association committed to make widely available. In addition, the NASD recognized the Association's right to derive economic benefit from the dissemination of both last sale and historical data. It was also understood between the NASD and the Association that the NASD would be responsible for the dissemination of "real-time" or last sale data.

There were several reasons for this understanding concerning historical and last sale data. First, although the regulatory mandate of the NASD to enhance corporate bond price transparency arguably extends to the dissemination of last sale data, the Association does not believe that such mandate necessarily extends to the dissemination of historical data. Similarly, the Association does not believe that the NASD must be the exclusive distributor of such data. Second, the Association's member firms strongly felt that firms providing trade data should be free to commercialize historical data in their discretion, within the requirement that historical data should be made widely available on a reasonable and non-discriminatory basis to all persons who want that data.

The Association believes that the distinction between last sale data and historical data for a particular bond is important from both a functional and a legal point of view. Last sale data is simply information concerning the last transaction in a particular bond at a particular point in time. Historical data can be valuable when combined with other data sources and analytic methods to produce matrix pricing systems and interest rate curves. Historical data may also be useful in examining past trading trends and characteristics in order to arrive at trading strategies.

The Association recognizes, from a technical perspective, that recipients of last sale data could conceivably store a stream of last sale data and thereby accumulate a historical database. However, contractual restrictions could and should be placed on recipients' further commercial use of accumulated last sale data. Therefore, legal and functional distinctions exist for last sale and historical data that would permit the separate licensing and use of the two categories of data.

An outgrowth of the distinction between last sale data and historical data is that the same entity does not necessarily need to be the distributor of both categories of data. For example, an entity sponsored by the Association could choose to register as an ESIP for historical data. Within the regulatory requirements imposed on ESIP's, that entity could commercialize historical data separately from last sale data. Such an approach would be consistent with the functional distinction between last sale and historical data and would permit the Association to commercialize historical data in a coherent and independent fashion. Alternatively, the Association could agree with the NASD that the NASD would commercialize historical data for the account of the firms that contribute data into the corporate bond reporting system, thereby permitting those firms to retain by contract the economic benefits of historical data. There is no regulatory reason why one of the two models described above for the treatment of historical data should be preferred over the other. Either approach would permit the accomplishment of the regulatory mandate to enhance transparency in the corporate bond market through the dissemination of trade data.

The Association therefore believes that the NASD's proposal should be clarified on the following points:

Last sale data and historical data should be treated as two distinct categories of data for regulatory purposes.

Explicit recognition should be given to the economic interest of firms that contribute data in the revenues that result from the commercialization of data.

As long as the necessary steps are taken to register as an ESIP, an entity other than the NASD could be the distributor of historical data.

B. Firms Subject to Reporting Should be Relieved of the Requirement to Submit Clearing Agency Information to the NASD.

In response to a concern expressed by NASD Regulation regarding the quality of data submitted for surveillance purposes, the NASD has proposed a new reporting obligation via proposed Rule 6231, in addition to the requirement to submit a trade report in accordance with proposed Rule 6230(c). This new obligation would apply to both sell-side and buy-side firms in an inter-dealer transaction and would require these firms to submit to the NASD the same data that is provided to such firms' clearing agency in connection with the clearing and settlement of the transaction. The NASD has stated its belief that this new obligation imposes "minimal additional burdens" on reporting firms.

The Association questions the NASD's need for this additional reporting obligation and strongly disagrees with the NASD's assessment of the additional burden on reporting firms. Although the Association understands the NASD's concern about the integrity of the data reported for surveillance purposes, the NASD's amended proposal already contains an obligation on the part of reporting firms "to report transaction information promptly, accurately and completely." 12

In addition, the burden of this new obligation is not minimal. In order to build the infrastructure required to fulfill the obligation to submit trade reports, broker-dealers will already incur substantial technology, training and personnel expenses. The focus of broker-dealers' efforts in the efficient management of operational matters has been to report data once, rather than multiple times through different communications channels. The NASD's new reporting obligation would require a firm to report transaction information twice, first to its clearing agency and a second time to the NASD. Such a requirement is duplicative and inefficient.

The Association believes that there may be a less burdensome method of satisfying NASD Regulation's concern about data integrity. Such a method would involve the submission by both sell-side and buy-side firms of the trade report required under proposed Rule 6230(c) in cases involving inter-dealer trades. In these cases, NASD Regulation would have available to it trade reports from both sides of the transaction that could be matched in NASD Regulation's surveillance system. The Association believes that firms reporting via automated systems would incur relatively little incremental expense in adding a requirement that buy-side reports be submitted for inter-dealer trades. However, the Association is of the view that the burden of such a solution on firms that submit reports to the NASD via a Web browser option may be substantially greater. The Web browser option essentially involves the manual input of data that is accumulated into a trade report submitted over the Internet. Thus, firms using this reporting channel would potentially be required to double the amount of resources that they use to submit reports in a non-automated environment. The Association believes that the impact would be most strongly felt by smaller firms with transaction volumes that do not justify automated reporting systems. 13

IV. Implementation Issues Raised by the NASD's Amended Proposal.

The Association wishes to register its views on certain implementation issues that are raised by the NASD's amended proposal, even though these views do not require revisions as such. 14

A. Consideration Should be Given to Modifying the Time Frame for Implementation of 15-Minute Trade Reporting In Order to Facilitate the Transition to Straight-Through-Processing.

The focus by broker-dealers on the reporting of data once rather than multiple times, as discussed above, has implications for the mechanics of trade reporting over the longer term. Many firms have expressed the desire to use a utility as an intermediary to submit trade reports to the NASD. 15 The reason is that the information transmitted by a firm to its clearing agency for purposes of settlement includes the data elements required by the trade reporting sections of the NASD's amended proposal. The Association believes, based on input from certain of its members and the National Securities Clearing Corporation ("NSCC"), that it may therefore be efficient for NSCC to act as agent for the submission of trade reports. In order for NSCC to act as agent for firms and to meet the initial one hour deadline for submission of trade reports, the existing system of batch processing of trade information would need to be accelerated. The Association has been advised that this step is technically feasible without an inordinate expenditure of time and money.

A more difficult issue, however, may be presented when the deadline for the submission of trade reports moves from one hour to 15 minutes. 16 Firms are currently in the process of making major investments in order to move to a T+1 settlement deadline and to "real-time," straight through processing of transactions. Although it is possible to accelerate the current batch processing mechanism for the submission of trade data to NSCC to comply

with the one-hour deadline, a substantially greater effort is required to move to reporting within 15 minutes. Certain of the Association's members have questioned whether the investment to move to 15-minute reporting is justified when these members are already planning to implement a real-time, straight through processing environment. Therefore, these firms strongly believe that the time frame for implementing 15-minute trade reporting should be coordinated with the transition to T+1 settlement and straight through processing. Such coordination would greatly enhance operating efficiencies within these firms and would aid in the movement to T+1 settlement and straight through processing of transactions. 17

B. Other Implementation Matters.

The Association notes that the NASD's amended proposal contemplates the execution of at least two contracts that are critical to implementation. These contracts are the agreement between the NASD and Nasdaq relating to the furnishing by Nasdaq of technology services to the NASD, and the agreement between the NASD and each firm that participates in the trade reporting system, 18 together with applicable rules and operating procedures for the system. The Association expects these contracts will be made available for review and comment prior to their execution and that the substantive provisions of these contracts will be consistent in all respects with the framework for trade reporting laid out in the NASD's amended proposal. In addition, competitive concerns dictate that the contractual arrangements essential to the implementation of trade reporting are done on an arm's length basis between the NASD and Nasdaq.

The NASD has not yet disclosed the costs associated with the establishment and maintenance of the systems that will be put in place for either reporting or surveillance of corporate bond transactions. The absence of a competitive process in the NASD's designation of its own trade reporting system as the single operative system for regulatory purposes makes the issue of the NASD's costs all the more critical. The firms that will be expected to bear the costs of these systems should have an opportunity to understand the NASD's proposed cost structure and to evaluate the reasonableness of these costs well before the start of trade reporting. Essential aspects of this evaluation are the review of the technical specifications for the trade reporting system, which should be published as soon as possible, and the establishment of performance benchmarks for Nasdaq as technology provider to the NASD.

In light of the numerous steps that will be required for implementation of trade reporting, the Association believes that it would be appropriate for the Commission to assess the status of completion of these steps at some point before the scheduled commencement of reporting. Such an assessment would permit both the NASD and firms to take stock of remaining items that must be accomplished to implement reporting and to determine whether additional time should be allotted to permit its orderly commencement.

V. Conclusion.

Once again, the Association is appreciative of the opportunity to comment on the NASD's amended proposal. We strongly support the framework of the NASD's amended proposal and believe that this framework will advance the cause of enhanced transparency in the corporate bond market while taking into account the Association's concerns about liquidity, governance and operational matters. We also strongly believe that the NASD's amended proposal should be further revised to provide clarity on broker-dealers' interest in historical data and the revenues resulting from the sale of data, to relieve broker-dealers of the requirement to submit clearing agency information, and to provide additional guidance on implementation matters. We look forward to continuing to work with the NASD on the implementation of the rules on corporate bond price transparency, as finally adopted by the Commission. Substantial progress has been made, but the implementation of such rules will require ongoing cooperation and good faith by all parties.

Should you have any questions or desire any clarification or additional information regarding any of the matters discussed in this letter, please do not hesitate to contact the undersigned or Michel de Konkoly Thege, Vice President and Associate General Counsel of the Association at 212.440.9476.

Sincerely,

/s/ William H. James, III
William H. James, III
Lazard Freres & Co. LLC
1999 Chairman
Corporate Bond Division
The Bond Market Association

/s/ Vincent Murray
Vincent Murray
ABN AMRO Incorporated
2000 Chairman
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Thomas Thees
Morgan Stanley Dean Witter & Co., Inc.
2001 Chairman
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cc: Securities and Exchange Commission
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Appendix A - Technical Comments on the NASD's Amended Proposal

Numerical references are to the rules contained in the amended proposal.

6210(a). The inclusion of "all investment-grade rated debt securities that are issued pursuant to Section 4(2) of the Securities Act of 1933" in the definition of TRACE-eligible security is inconsistent with the exclusion of such securities in 6230(e)(2). In addition, the definition of TRACE-eligible security should clarify whether coverage includes Rule 144A securities and should explicitly exclude mortgage-backed securities, asset-backed securities (including collateralized loan, debt and bond obligations) and capital securities.

6210(d). The word "parties" should be replaced with the term "parties to the transaction" defined in Rule 6210(e), and the word "insufficient" should be replaced with the word "sufficient."

6210(e). The term "clearing broker" is used, but the definition of clearing broker has been deleted in former Rule 6210(i).

6220(a)(2)(A). The term "TRACE Participant Application Agreement" is not defined.

6230(a)(1)(A). This rule refers to the obligation to report transactions within one hour after "trade execution." No defined term exists for "trade execution." The term "time of execution" is defined in 6210(d) and is appropriate to substitute for "trade execution."

6230(a)(1)(B). In the second sentence, the word "TRACE" should be replaced with the word "transaction."

6230(a)(2). The time of publication of daily market aggregates should be specified.

6230(c)(4) and 6230(d)(3). References to "cross," "in-house cross," "agency cross," and "principal cross" transactions should be defined.

6230(c)(12). The terms "TRACE Rules" and "TRACE Users Guide" are not defined.

6240. This provision is duplicative of 6230(a)(1)(B) and 6230(f).

6260(a). The reference to "Investment Grade corporate bonds" should be revised to read "Investment Grade TRACE-eligible securities." In addition, 6260(a), and possibly 6210(h) and (i), should be revised to clarify if the investment grade or non-investment grade status of the bonds to be reported should be as determined as of issuance, at the time of the reported trade or otherwise, in order to deal with the possibility of rating changes.

6270. The reference to "effective date of the offering" is not clear in the context of fixed income securities offerings and should be defined. If "effective date of the offering" is defined to mean the day on which the offering is priced, consideration should be given to the fact that CUSIP numbers may not be available until the day after the offering is priced, particularly if the offering is priced late in the day. The obligation to provide CUSIP numbers should be modified accordingly.

FOOTNOTES

The Association is the bond market trade association, representing 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 Association's Price Transparency Steering Committee, Corporate Bond Executive Committee, Corporate Bond Legal Advisory Committee, High Yield Bond Committee and Corporate Bond Operations Committee.

The NASD's proposed rule concerning corporate bond price transparency, as originally published for comment on December 10, 1999, is referred to as the "NASD's original proposal." The NASD's original proposal, as amended by Amendment Nos. 2 and 3, is referred to as the "NASD's amended proposal."

The Association also generally agrees with the commentary in the NASD's "Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change," which accompanied the NASD's amended proposal. However, we note that this Statement includes a section entitled "TRACE Data," which contains several references to the "goals" and "objectives" of a national market system. The Association believes that such references to a national market system are not applicable to the corporate bond market, which is predominantly an over-the-counter market.

As an alternative to further revision of the NASD's amended proposal, the Association would welcome commentary by the Commission consistent with the Association's positions on the issues and concerns that we believe require further revision.

Letter dated February 9, 2000 to Jonathan Katz concerning "Creation of a Corporate Bond Trade Reporting and Transaction Dissemination Facility - File No. SR-NASD-99-65" (referred to herein as the "Association's First Comment Letter").

The Association strongly believes that the BTRC should have the freedom to make recommendations concerning dissemination parameters in a manner that is not fettered by any presumption concerning the impact of dissemination on liquidity, the timing of such dissemination (whether immediate or delayed) or any other factors that may affect its judgments concerning such recommendations.

The Association expects that the articulation of the relationships among NASD, NASD Regulation and Nasdaq, whether by contract or otherwise, will be on an arm's length basis, consistent with the principles established in the NASD's amended proposal. The Association also expects that the BTRC will have both the ability and the opportunity to ensure adherence to appropriate commercial terms and conditions.

Notwithstanding the voluntary nature of the NASD's trade comparison feature, the Association notes that interoperability issues will arise to the degree that one party to a trade uses the NASD comparison feature and the other party to that trade uses a competitive comparison system.

The Association will incorporate into its operating procedures a set of objective criteria for the designation of the BTRC members to be recommended by the Association. The Association anticipates that the BTRC members to be recommended by it will consist of corporate bond market professionals, because the BTRC will need the expertise of such professionals, particularly on matters concerning dissemination parameters and their impact on liquidity.

The Association also notes that at least one additional condition should be satisfied before the 180-day implementation period begins to run. This condition is the publication by the NASD of technical specifications for the trade reporting system and the related user guide, which to our knowledge are not yet available and should be made publicly available as soon as possible. In addition, the NASD should quickly disclose to firms

subject to the trade reporting requirement all costs (and any resulting fees) associated with both the surveillance and reporting/dissemination aspects of the system.

The Association has consistently taken the position that firms that contribute data to a trade reporting system should be the principal beneficiaries of the economic value resulting from the commercialization of that data. See the Association's First Comment Letter, pages 20-21. The NASD has recognized the economic interest of firms that contribute data in discussions with the Association that preceded the publication of the NASD's amended proposal, but the NASD's amended proposal does not adequately address this issue.

Proposed Rule 6230(a)(1)(B). See also proposed Rules 6230(f) and 6240.

The Association also notes that the NASD has proposed to add a new element to the trade report that was not included in the NASD's original proposal. The new element is yield information "as required by Rule 10b-10." Although the Association acknowledges the usefulness of yield information, information concerning yield in most firms is reported via existing systems that generate confirmations as required by Rule 10b-10. The addition of yield information to the trade report will require these existing systems to be integrated with the systems created to report trades as required by the NASD. The integration of these systems involves additional expense, along with the possibility that discrepancies in the reporting of yield information may result.

The Association has communicated certain technical comments concerning the NASD's amended proposal to the staff of the NASD, which we understand are currently under consideration. We have attached technical comments as Appendix A hereto.

Proposed Rule 6230(a)(1)(B) now explicitly recognizes that a firm "may employ an agent for the purpose of submitting transaction information."

The Statement accompanying the NASD's amended proposal states that within "six months after the start of . . . reporting, the 1 hour maximum time period to submit . . . trade reports will be reduced to 15 minutes, subject to the ability of firms to comply technologically and operationally." (emphasis added)

Operations professionals from the Association's member firms would be pleased to work with staff of the NASD and the Commission, as well as other industry organizations, to explain in detail the need for flexibility in the transition to 15-minute reporting and possible timetables for such transition.

This agreement is presumably the one referred to as the "TRACE Participant Application Agreement" in proposed Rule 6220(a)(2)(A).

