

Comment Letter on NASD Proposal Concerning Corporate Bond Facility, December 2000

December 20, 2000

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

Re: NASD Notice of Filing of Amendment Nos. 2 and 3 to Proposed Rule Change Relating to the Creation of a Corporate Bond Trade Reporting and Transaction Dissemination Facility and the Elimination of Nasdaq's Fixed Income Pricing System (File No. SR-NASD 99-65)

Dear Mr. Katz:

The Investment Company Institute¹ appreciates the opportunity to comment on the National Association of Securities Dealers, Inc.'s proposed amendments to its proposal to establish a corporate bond trade reporting and transaction dissemination facility.² The proposed amendments reflect certain changes to the NASD's original proposal regarding the creation of a Trade Reporting and Comparison Entry Service ("TRACE").³ That proposal, among other things, would have required NASD members to submit corporate bond trade reports to TRACE, which would then disseminate certain transaction information to the public via market data vendors. As part of this initiative, and simultaneous with the effectiveness of the new rules, the NASD proposed to eliminate Nasdaq's Fixed Income Pricing System and its related rules and costs.

The Institute, on behalf of its members who are significant investors in corporate debt securities, submitted a comment letter on the NASD's original proposal generally supporting TRACE, but expressing concern regarding various aspects of the proposal.⁴ We are pleased that the NASD's proposed amendments address several of these concerns.⁵ Unfortunately, the amendments do not address all of them.⁶ Therefore, we urge the NASD to reconsider the comments expressed in the Institute's letter (a copy of which is attached) that were not reflected in the proposed amendments. In addition, the amendments propose a new structure for monitoring the operation of TRACE, which raises an additional concern.

The Proposing Release notes that the NASD intends to create a new committee, the Bond Transaction Reporting Committee (the "Committee"), that will advise the NASD Board of Governors on issues related to the operation of TRACE, including, among other things, the setting of fees for disseminating real-time TRACE data to the public. The Committee will also review the effects on liquidity associated with disseminating fixed income transaction information, and make recommendations to the NASD Board concerning appropriate time frames for publicly disseminating smaller, less-actively traded issues. The Institute supports the NASD's initiative to create a market transparency committee that will focus on TRACE-related issues. Our concern relates to the composition of the Committee.

As proposed, the Committee would consist of eight persons selected by the NASD Board of Governors. Four of the members would be recommended by the staff of the NASD, while the other four would be recommended by The Bond Market Association. The likely result of this will be eight "sell-side" representatives on the Committee. We strongly recommend that the proposal be modified to ensure equal "buy-side" representation. In order for TRACE to be successful, it is important that the views of both market constituents be considered and reflected in all significant developments affecting the structure and operation of TRACE prior to the making of recommendations to the NASD Board. We note that the composition of the Committee could be structured similar to that of the Nasdaq Quality Markets Committee, the advisory committee that focuses on equity market structure issues. The members of that committee are drawn equally from both buy-side and sell-side organizations. Having appropriate representation is especially important given the role the Committee will have in formulating policies, setting fees, and assessing the impact that disseminating trade data may have on liquidity. The NASD makes clear that the NASD Board will give "significant weight to the advice and

recommendations of the [Committee]."⁷ This is all the more reason why it is imperative that representatives of investors participate on the Committee. Their involvement will only enhance the effectiveness of the Committee and ultimately allow TRACE to achieve its important objectives.

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The Institute appreciates the NASD's consideration of our views on this important proposal. If you have any questions, or would like additional information, please contact me at (202) 326-5923.

Sincerely,

Barry E. Simmons
Associate Counsel

Attachment

cc: Justin J. Tubiolo, Vice President
Fixed Income Securities
The Nasdaq Stock Market, Inc.

Annette Nazareth, Director
Division of Market Regulation

Paul F. Roye, Director
Division of Investment Management
U.S. Securities and Exchange Commission

ENDNOTES

¹ The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,358 open-end investment companies ("mutual funds"), 489 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about \$7.161 trillion, accounting for approximately 95% of total industry assets, and over 83.5 million individual shareholders.

² SEC Release No. 34-43616 (Nov. 24, 2000); 65 Fed. Reg. 71174 (Nov. 29, 2000) (the "Proposing Release").

³ SEC Release No. 34-42201 (Dec. 3, 1999); 64 FR 69305 (Dec. 10, 1999).

⁴ See Letter from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, SEC, dated February 8, 2000.

⁵ For example, we are pleased that the NASD has determined to add disclosure of yield to TRACE trade reports determined in conformity with Rule 10b-10 under the Securities Exchange Act of 1934. Yield information would provide a valuable mechanism to match, verify and analyze pricing of corporate bonds.

⁶ For example, we recommended that the threshold level for disseminating trade report information for high yield and unrated trades be increased from \$1 million to \$5 million in recognition of the fact that transactions in these bonds routinely exceed \$5 million and that this disclosure would provide the market with more relevant and useful information than would be provided by a lower threshold. Also, we remain concerned about the fee levels that NASD will impose for collecting and disseminating trade data and recommend that they be tied to some type of cost-based standard in order to preclude excessive profits.

⁷ See Proposing Release at 12.