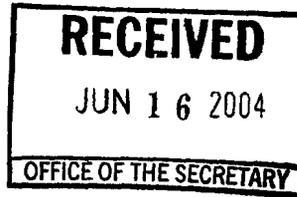


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TO: Annette Nazareth

FROM: George Miller and Lynnette Hotchkiss

DATE: June [16], 2004

RE: **File No. SR-NASD-2003-201 – Proposed Expansion of the NASD's Trading Activity Fee to TRACE-Eligible and Municipal Securities: Summary of Unresolved Issues in NASD Response to Comments dated May 19, 2004**

As you know, The Bond Market Association recently submitted a comment letter (dated February 17, 2004) to the Commission outlining our serious concerns regarding the NASD's proposal to extend its Trading Activity Fee ("TAF") for the first time to TRACE-eligible and municipal securities (the "Debt TAF"). Thirteen other comment letters were also filed opposing the Debt TAF. Further to your conversation with George Miller last week, the following is a bullet-point summary of the important issues raised in the Association's letter which we believe were not adequately addressed in the NASD's response to comments and which remain unresolved. A copy of our comment letter is also attached for your review and reference.

Inadequate Financial Disclosure Provided by the NASD

- **TBMA Comment:** The proposal does not provide enough information to permit an appropriate evaluation of whether the Debt TAF complies with Section 15A(b)(5) of the Exchange Act, which requires the "equitable allocation of reasonable dues, fees and other charges" among members. Disclosure of some financial information and analysis supporting the NASD's claims that its overall fee structure is "revenue neutral" and reflects its regulatory efforts in the fixed income markets is needed and requested on behalf of its members.

NASD Response: Following an earlier notice and comment period, the Commission previously approved NASD's regulatory pricing structure as consistent with Section 15A(b)(5), and thus "reasonable" and "equitably allocated." The SEC additionally "urged" the NASD to implement the TAF in all areas the NASD oversees – to better allocate regulatory costs to those activities. The proposal extends the approved pricing structure to TRACE-eligible securities and munis. Additionally, it was stated, without citation, that NASD need not specify costs and revenues on a product by product basis to demonstrate consistency with Section 15A(b)(5).

Without any financial disclosure supporting the need for the Debt TAF, serious questions about the reasonableness and fairness of the fees remain unaddressed

and a meaningful opportunity for informed public comment has not been provided. At a minimum, the NASD should provide financial disclosure establishing a reasonable nexus between the regulatory costs it seeks to fund and the Debt TAF.

Double Taxation

- **TBMA Comment:** NASD should be required to establish that adding the Debt TAF on top of existing transaction-related regulatory fees (i.e. TRACE and MSRB fees) does not constitute “double taxation” of these securities. Particularly troubling is the fact that TRACE fees already include a charge that was intended to recover costs incurred in connection with the surveillance and oversight of the fixed income markets.

NASD Response: The Debt TAF does not constitute a redundant assessment. NASD is responsible for enforcing MSRB rules, though it does not receive any portion of the fees the MSRB collects from its members. “Regulatory costs funded by the TRACE fee structure are not funded by any other fees or assessments of NASD,” which will continue to be the case after the Debt TAF is implemented. “Consequently, NASD will not charge duplicative member regulatory fees on TRACE-eligible securities.”

A fair and reasonable regulatory regime would not tax firms with duplicative fees. The MSRB maintains a large surplus each year from fees (the MSRB had net assets of \$17,788,914 as of September 30, 2003) and the NASD should receive a portion of these fees for enforcing MSRB rules before assessing a new and onerous fee. In the case of TRACE fees, the NASD’s response is circular and non-responsive to our comment. Stating that “costs funded by the TRACE fee structure are not funded by any other fees” does not answer the fundamental question: Since the NASD already collects millions of dollars annually in TRACE fees (well over \$12.4 million in TRACE fees since July 2002), with the stated purpose of “engaging in oversight of the fixed income market”, why does it need additional revenue for regulatory oversight of the corporate bond market?

Disparate Impact

- **TBMA Comment:** The Debt TAF will have a disparate impact on retail-oriented firms and investors because it effectively reduces the fee per bond for larger transactions. Municipal securities dealers will also be competitively burdened as bank municipal securities dealers (that are not members of NASD) will not be subject to the Debt TAF.

NASD Response: NASD recognizes that the proposed fee cap will result in a higher aggregate fee on retail activity, but retail trades generally drive member regulatory costs as much as, if not more than, institutional trades. NASD has proposed a cap consistent with its goal of assessing a reasonable fee that is fairly allocated among its members and reflective of its regulatory functions, efforts and

costs. NASD is not in a position to comment on the fees imposed on bank municipal securities dealers that are not NASD members.

Lack of Coordination on SRO Fees

- **TBMA Comment:** SRO fees need to be coordinated across all SROs with overlapping jurisdictions. Without such coordination, there can be no guarantee against unreasonable and unfair fee burdens for member firms and SROs. The adoption of the Debt TAF without further disclosure and justification may prompt various SROs to impose or increase their own fees based on vaguely defined regulatory costs.

NASD Response: Most SROs do not have the broad regulatory responsibilities NASD has regarding members' activities with customers, and, in NASD's view, are unlikely to demonstrate a sufficient regulatory nexus to impose a transaction fee on fixed income securities transactions that do not occur in the SRO's market.

The lack of coordination between the NASD and MSRB on fees and the NASD's desire to collect both TRACE fees and the Debt TAF for regulatory oversight of the corporate bond market are perfect examples of instances in which overlapping fees need to be coordinated among (and within) SROs. Failing to provide some minimum amount of financial disclosure and justification for the Debt TAF in light of these existing transaction-related fees will set an unfortunate precedent for the assessment of new SRO fees without meeting the statutory requirements under the Exchange Act.

Implementation Issues Not Addressed

- **TBMA Comment:** Many practical questions regarding how the Debt TAF will be implemented remain unanswered (i.e., how agency and riskless principal guidance currently applicable to equity securities would be applied to the Debt TAF, how the Debt TAF will apply to inter-dealer brokers and brokers' brokers, the treatment of transactions with investment advisors, etc.). Understanding how the Debt TAF will be implemented is integral to evaluating whether the proposal is fair and reasonable and to assessing the overall burden it will impose on member firms.

NASD Response: NASD will address interpretive issues with respect to the application of the Debt TAF in a Notice to Members. In general, it expects to apply the TAF to equity and debt securities in as consistent a manner as possible.

Without knowing more about how the Debt TAF will be implemented, it is impossible to evaluate whether it is fair and reasonable and the overall burden it will impose on member firms. Providing this crucial information after the approval of the Debt TAF will not afford the industry meaningful opportunity to assess and comment on the proposal.