SIFMA
Securities Industry and
Financial Markets Association

May 7, 2009

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File Number SR-FINRA-2009-010, Proposed Rule Change Relating to the Expansion of TRACE to Include Agency Debt and Primary Market Transactions

Dear Ms. Murphy:

The Capital Markets Group of the Securities Industry and Financial Markets Association[1] ("SIFMA") appreciates the opportunity to comment on SR-FINRA-2009-010 (the "Filing"), which the Financial Industry Regulatory Authority, Inc. ("FINRA") has submitted to the Securities and Exchange Commission ("Commission") for approval. In the Filing, FINRA proposes to expand TRACE reporting to include (i) transactions in certain securities that are issued or guaranteed by a government-sponsored enterprise ("GSE") or a U.S. government agency (collectively, "Agency Debt ") and (ii) primary market transactions in TRACE-eligible securities.

SIFMA supports efforts by FINRA and by the Commission to increase transparency, and thereby market integrity and investor protection, in the fixed income markets. SIFMA is committed to making the fixed income markets more transparent, particularly for the retail investor, and as part of this commitment disseminates both TRACE and Municipal Securities Rulemaking Board ("MSRB") municipal bond price information free of charge on its investor education website, www.investinginbonds.com. SIFMA's comments on the Filing are offered in the spirit of the ongoing and constructive working relationship that has existed between SIFMA and FINRA concerning bond price transparency and the evolution of TRACE reporting. As discussed in greater detail below, SIFMA (i) believes that any expansion of TRACE reporting to Agency Debt or primary market transactions would impose significant costs on firms who engage in such transactions and (ii) recommends that FINRA modernize the TRACE reporting infrastructure and make certain revisions to the proposed rule change to minimize burdens and costs associated with TRACE reporting.

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 600 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington, D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

I. Proposed Expansion of TRACE to Agency Debt

A. Cost-Benefit Analysis.

SIFMA believes that the proposed expansion of TRACE to Agency Debt requires careful analysis in order to determine if any possible benefits attributable to TRACE reporting are outweighed by the costs for implementation and ongoing compliance. In the Filing, FINRA states that it proposes to expand TRACE reporting to cover Agency Debt in order "to provide additional transparency and to foster the development of improvements observed in corporate bonds – improved pricing, narrower bid-ask spreads, reduced investor costs, and more precise valuations." SIFMA believes that the Agency Debt market, which is a highly liquid market already characterized by a high degree of transparency and very narrow bid-ask spreads, is materially different from the corporate bond market, which is relatively illiquid by comparison and generally exhibits significantly wider bid-ask spreads. Because of the material differences between the two markets, it is unlikely that expanding TRACE reporting to the Agency Debt market will result in the same benefits that FINRA believes it has observed as a result of requiring TRACE reporting in the corporate bond markets. On the other hand, the costs of extensive system changes required by the expansion of TRACE to Agency Debt and the ongoing compliance costs are significant and certain to be incurred. These costs would be compounded by undue compliance burdens and costs resulting from the lack of flexibility that currently exists with the infrastructure of TRACE, unless FINRA modernizes the TRACE infrastructure before embarking on the proposed expansion.

Bid-ask spreads in the Agency Debt market are already very narrow. In explaining its rationale for expanding TRACE reporting to Agency Debt, FINRA states that it believes such an expansion will result in changes similar to those that it has observed in the market for corporate bonds, including narrower bid-ask spreads. SIFMA believes it unlikely that expansion of TRACE to the Agency Debt market would materially reduce bid-ask spreads in Agency Debt. Bid-ask spreads in the Agency Debt market are already quite low, often as low as two cents, and are routinely inside of ten cents.

The Agency Debt market is already transparent. Pricing information is widely available to investors through broker-dealers and through existing reporting services. Many investors and broker-dealers also have access to trading screens (*e.g.*, from ICAP/Brokertec, Tradeweb and Bloomberg) with actionable or indicative quotations for many issues of Agency Debt. Many broker-dealers also make pricing information available to customers on their websites. In addition, media outlets such as the Wall Street Journal and certain private websites make certain pricing information available.[2]

The Agency Debt market is principally an institutional market. The principal participants in the Agency Debt market are institutions who have ready access to multiple sources of pricing information. Retail customers often purchase a very small percentage, at times less than one percent, of Agency Debt issues.[3]

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[2] Market participants actively compete on the basis of the information they provide to customers, and, as a result, mandating TRACE reporting (and disseminating the resulting information) may be harmful to the competitive environment.

[3] See, *e.g.*, data available at http://www.fanniemae.com/markets/debt/debt_tools_resources/bass.jhtml?p=Debt+Securities&s=Debt+Tools+%26+Resources&t=Benchmark+Automated+Syndication+System# and http://www.fanniemae.com/markets/debt/benchmark_securities/general_info/benchmark_notes_dist_reports.jhtml.

Possible competitive disparities. Expanding TRACE reporting to cover Agency Debt may cause competitive disparities between FINRA member firms, which are subject to TRACE reporting, and bank government securities dealers, which are not. Bank government securities dealers would not be required to incur the substantial expenses necessary to establish systems to comply with TRACE reporting requirements and would not incur the ongoing compliance costs of TRACE reporting. Such dealers would also have an advantage over FINRA members in competing for the business of any institutional investors that wish to keep their trading activity confidential.

B. Suggested Revisions to the Proposed Rule Change and TRACE Infrastructure.

Definitions should be clarified. The definitions of "Agency" and "Government-sponsored enterprise" are highly complex, technical, and open to different interpretations. FINRA could significantly reduce the definitional uncertainty by publishing a list of the issuers that qualify as an "Agency" or as a "Government-sponsored enterprise." SIFMA strongly recommends that it do so. At a minimum, SIFMA suggests that FINRA consider defining the new types of covered securities by reference to the definitions of "government securities" in Exchange Act Section 3(a)(42) or the language of the exemption from registration in Securities Act Section 3(a)(2). Firms are already familiar with this definition and exemption, and extensive guidance already exists as to what securities fall into these categories.

TRACE should be modernized to reduce the costs of TRACE reporting. If FINRA proceeds with the expansion of TRACE to Agency Debt, there are a number of ways in which the proposal and the TRACE infrastructure should be modified to eliminate unnecessary and costly operational burdens on firms. SIFMA and its members would be pleased to work with FINRA to develop ways in which the infrastructure of TRACE could be modernized to make it more user-friendly to ensure accurate and timely reporting without unduly burdening firms. Trade modifications are an area of particular concern. SIFMA believes that TRACE should permit firms the flexibility to cancel or correct trade reports, similar to that which is currently provided in the MSRB's Real-Time Transaction Reporting System and FINRA's Order Audit Trail System, without incurring a change fee, a "Late Trade" violation or the costs of a compliance review. Currently, TRACE imposes a rigid cost and compliance structure that does not allow for modifications, even though revisions to trade details often do not reflect compliance failures by the reporting firm. Instead, many of the modifications are made to accommodate customers, *e.g.*, by accepting allocations among accounts outside of the 15-minute reporting window, by amending settlement terms pursuant to a client's request or by giving clients price improvement as a result of a best execution review outside of the reporting window.[4] These compliance costs are particularly significant in comparison to the broker-dealer's profits on small trades and odd lots, so dealers may be less likely to make markets for such trades if Agency Debt reporting is required without changes to TRACE's

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[4] It is important to note that these trade modifications are common to both primary and secondary market transactions in both the agency debt market and the market for corporate securities. A firm should not be penalized for modifications that result from servicing the needs of the firm's customers. TRACE compliance costs for trade modifications (which are treated as late trade reports) may make firms less flexible with client requests, potentially negatively affecting the market. SIFMA requests that FINRA consider differentiating between late trade reports (original reports) and late trade amendments and consider late trade amendments less egregious. SIFMA also requests that FINRA consider providing different peer group banding to distinguish between firms with primary market trades and/or institutional flow compared to retail flow to better measure firms against peers with similar business models. Possible changes could include banding firms on the basis of primary market trade volume or by trade volume rather than trade report volume.

infrastructure.[5] Unless the TRACE infrastructure is modernized, given the likelihood of a sizeable increase in volume and ticket count associated with the reporting of Agency Debt, there is significant chance that the system will be unmanageable for both dealers and FINRA alike, resulting in trade execution being more costly and the unintended consequence of wider spreads (especially with respect to smaller trades where the reporting and compliance costs constitute a significant fraction of the dealer markup).

TRACE fees should be reduced for Agency Debt. If TRACE is expanded to cover Agency Debt, TRACE fees should be reviewed in light of the additional revenue to be derived from these additional types of transactions and should be reduced to the extent the additional TRACE fees are not necessary to cover FINRA's expenses in connection with the collection and dissemination of TRACE data. In particular, FINRA should eliminate the fees charged for modifications of transaction reports submitted in good faith. In setting the fees for TRACE reporting on Agency Debt, FINRA should be mindful that the current fees with respect to TRACE reports may constitute a significant proportion of the extremely narrow spreads on Agency Debt.

II. Proposed Expansion to Primary Market Transactions

The expansion of TRACE to require reporting of primary market transactions would pose significant operational and compliance issues and would require firms to engage in extensive and costly systems development. For many firms, the development would need to be duplicated on multiple systems because they do not have one single system or process that captures all primary market transactions and the systems that do capture primary market transactions are not integrated with those presently reporting to TRACE. We believe that to facilitate implementation and avoid undue compliance burdens and costs the proposal should be revised or implemented in a manner that addresses the issues discussed below.

Firms should be permitted to rely on the TRACE Issue Master. If TRACE is expanded to cover primary market transactions, broker-dealers should be permitted to rely on the TRACE Issue Master that is available for firms to download at 6:30 a.m. Eastern time each trading day as the definitive listing of all securities that are subject to TRACE reporting for that day. Firms need automated system solutions for TRACE reporting in order to submit trade reports within the specified timeframes. Many firms have designed their systems to download the TRACE Issue Master each morning and use the inclusion of a security on the TRACE Issue Master to determine whether a transaction in such security is reportable to TRACE. These firms typically use the TRACE Issue Master as a "filter" against their secondary trading, so that each CUSIP on the list is automatically reported to TRACE. Although FINRA may update the list intraday on the TRACE website, the TRACE Issue Master is not published for download intraday and it is not operationally feasible for firms to manually monitor the TRACE website for intraday updates to the TRACE Issue Master. This makes it difficult for firms to designate securities that have been added to the TRACE Issue Master as subject to TRACE until they receive the revised TRACE Issue Master the morning after the addition of the security to the TRACE Issue Master. Although individual firms could make their own case-by-case determination whether a security is subject to TRACE, it would be extremely difficult for firms to identify every potentially TRACE-eligible security not on the TRACE Issue Master to make such a determination. In any event, such a requirement

[5] SIFMA strongly believes that this modernization of TRACE infrastructure should be applied to reporting of transactions in corporate debt and should be carried out whether or not TRACE is expanded to Agency Debt.

would lead to non-uniform reporting as firms resolve interpretative issues in differing manners.[6]

Moreover, FINRA currently rejects reports of transactions in a security not designated as TRACE-eligible by the TRACE system, even if the CUSIP number for the security has been submitted to FINRA. For example, new issue security information is typically provided to FINRA by an underwriter prior to pricing, but the security will generally not be posted to the TRACE Issue Master until after one to two days of trading, causing a significant number of rejected secondary trade reports. (It should be noted that addressing these rejections requires time and effort from both FINRA and the reporting firms.) SIFMA therefore respectfully requests that, before FINRA requires firms to report new issue transactions, it consider how to update the TRACE Issue Master on a real-time basis.

Accordingly, to avoid undue compliance burdens, SIFMA recommends that FINRA (i) revise the TRACE reporting requirement to make it clear that firms' TRACE obligations are limited to transactions in securities that are on the TRACE Issue Master as of 6:30 a.m. Eastern time and (ii) upgrade FINRA's TRACE Issue Master to accept new securities on a real-time basis and improve TRACE's ability to accept trade reports for transactions occurring shortly after pricing.

TRACE should be modernized to reduce the costs of TRACE reporting. As discussed above with respect to the expansion of TRACE to Agency Debt, the TRACE infrastructure should be modified to eliminate unnecessary and costly operational burdens on firms, including by providing additional flexibility to cancel and correct transactions and eliminating of duplicate reporting of intra-dealer transactions. The ability to cancel and correct transactions efficiently is particularly important for primary market transactions as modifications to transactions between execution (*i.e.*, pricing) and settlement are extremely common in primary market transactions.[7] SIFMA, in order to work collaboratively with FINRA, will form a Task Force to provide FINRA with market input on the process of modernization.

The distinction between primary and secondary market transactions should be clarified. FINRA should provide greater clarity as to what constitutes a primary market transaction. For example, clarification is needed as to the treatment of issues that do not have an underwriting syndicate.

End-of-day reporting for list or fixed price and takedown transactions should not be limited to first day. The exception from 15-minute reporting for list or fixed price and takedown transactions should not be limited to the first day of the offering. Disclosure of prices in such transactions completed after the first day of the offering are not likely to contribute meaningfully to price discovery and, accordingly, should be allowed the flexibility of end-of-day reporting provided for transactions completed the first day of the offering.

FINRA should consider deferring reporting of primary market transactions in Agency Debt. The primary market in Agency Debt differs significantly from the

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[6] The alternative of allowing firms to rely on the TRACE Issue Master but requiring them to "back report" transactions executed prior to the security's appearance on the TRACE Issue Master would impose additional significant system development costs on firms and should not be adopted.

[7] One firm reported an average of 10% of all primary market transactions were modified between execution and settlement, principally to reallocate settlement responsibility among members of the selling syndicate.

primary market for corporate bonds. The syndicate process is not as formal, and most new issues do not follow the standard corporate bond book-building model. On any date, there may be 50 to 100 new Agency Debt issues of various sizes, and new issue takedown, pricing, and primary and secondary market trades frequently occur on a single date. Agency Debt new issues also may vary as to when they are free to trade in the secondary market. In fact, if the market moves on the first day, the transactions may change from primary market sales at the list offering price to secondary market trades. Reporting primary market trades in Agency Debt would raise a number of complex operational issues. Firms may not receive CUSIPS for Agency Debt from the issuers for 25 minutes after trading has begun (and it takes time for even the dealers involved in the primary distribution to enter those CUSIPs into their internal systems). In light of the significant differences between primary market transactions in corporate and Agency Debt, SIFMA requests that, if FINRA proceeds with requiring Agency Debt and primary market transactions to be reported to TRACE, it consider phasing in Agency Debt primary market reporting after Agency Debt secondary market reporting and corporate bond primary market reporting.

III. Implementation Period.

Flexibility is needed with respect to the implementation period. The proposed expansion to cover Agency Debt and primary market transactions would likely at least double the number of transactions that must be reported to TRACE. Such a change would require major infrastructure changes both for FINRA and for SIFMA members. Many firms use systems and processes for trading Agency Debt and executing primary market transactions that are very different from those used for trading securities that are currently TRACE-eligible. SIFMA requests FINRA to work with SIFMA and the affected firms to facilitate implementation of any expanded reporting requirements in a manner that will provide firms with the flexibility to implement any changes without imposing undue expense and unnecessary and inappropriate compliance burdens.

SIFMA also recommends that any expanded reporting requirements be phased in by being implemented first for secondary transactions in Agency Debt, then for primary market transactions in corporate bonds, and then for primary market transactions in Agency Debt. It recommends that FINRA consider providing other relief with respect to implementation, at least initially, such as providing for an initial trial period where reports are made within 90 minutes (as was permitted when TRACE reporting was introduced for corporate bonds), rather than immediately requiring reports within 15 minutes of trade execution.

Finally, SIFMA urges FINRA to provide for an adequate implementation period after the publication of the technical specifications of each phase of any expansion of TRACE reporting. Firms' infrastructures for handling Agency Debt and primary market transactions vary widely. For some firms, making the necessary changes and adequately testing them may well take as much as eighteen months from the time the technical specifications for the expansion are released.[8] The length of time needed to build appropriate systems will depend significantly on yet-to-be-released FINRA specifications for any expansion and the degree to which FINRA modernizes its own infrastructure to deal with existing problems. It is doubtful that many firms could readily make the necessary changes within the 180-day period specified in the Filing, even if that period were to begin with the release of the technical specifications, rather than the date the SEC's approval is published in the Federal Register (as proposed in the Filing). We believe that issues as to the implementation of any changes to TRACE reporting would be best addressed by an ongoing dialogue between FINRA and SIFMA and its members and would be pleased to work with FINRA in that regard.

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Thank you again for the opportunity to provide our comments. We would be pleased to discuss these issues in greater deal with the Commission or FINRA staff. Sean Davy may be reached in this regard at 212-313-1118 or at sdavy@sifma.org, and Robert Toomey may be reached at 212-313-1124 at rtoomey@sifma.org.

Sincerely,

Sean C. Davy
Managing Director

Robert Toomey
Managing Director and
Associate General Counsel

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8 Many firms use different trade entry systems for their Agency Debt trades and corporate debt trades. These firms will not be able to leverage their existing TRACE reporting infrastructure for Agency Debt. Among other things, implementation of TRACE for Agency Debt will require such firms to: (i) build a new reporting infrastructure and connection to the TRACE system; (ii) change their new account opening and customer account data systems to add fields which currently do not exist (*e.g.*, "TRACE Counterparty", "MPID" and "C"); (iii) program their systems to feed the "MPID" or "C" from their customer account data system to their Agency Debt trade entry system; (iv) program their systems to automatically feed the file of TRACE eligible securities to their Agency Debt trade entry system on a daily basis, and (v) create customized systems to comply with the specific parameters outlined in the primary market reporting proposal.