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May 4, 2006



Ms. Nancy Morris
Secretary
U.S. Securities and Exchange Commission
10 F Street, N.E.
Washington, DC 20549-1090

**Re: SR-NASD-2006-005 - Proposed Rule Change to Expand
the Scope of NASD Rule 2440 and Interpretive Material 2440
Relating to Fair Prices and Commissions to Apply to All
Securities Transactions**

Dear Ms. Morris:

The Bond Market Association (“Association”)¹ appreciates the opportunity to comment on the above-referenced proposal (the “Proposal”) submitted by the National Association of Securities Dealers, Inc. (the “NASD”) to expand the applicability of NASD Rule 2440 and related Interpretive Material.² The Association believes that the Proposal raises significant questions about the jurisdiction of the various self-regulatory organizations (the “SROs”) and about the overlap between those jurisdictions. In particular, the Association believes that the Proposal raises a substantial question as to which SRO, or SROs, has or should have oversight authority as to the pricing of any transaction effected on an exchange: is it the NASD, the exchange, or both? The Association does not believe that the Proposal should be approved by the Securities and Exchange Commission (the “Commission”) if the answer to that question is that multiple regulators will now have overlapping and potentially inconsistent authority.

The Association’s concern as to the issue of clear lines of regulatory jurisdiction is made more immediate by the recent proposal of the New York Stock Exchange (the “NYSE”) to expand its trading of fixed income securities through the Automated Bond System (the “ABS”).³ In its comment letter on ABS, dated August 15, 2005, the Association noted that, because of ambiguities in the lines of regulatory jurisdiction between the NASD and the NYSE, transactions on ABS could be subject to needlessly

¹ The Association is a trade association that represents approximately 200 securities firms, banks and asset managers that underwrite, trade and invest in fixed-income securities in the United States and in international markets. Fixed income securities include U.S. government and federal agency securities, municipal bonds, corporate bonds, mortgage-backed and asset-backed securities, money market instruments and funding instruments such as repurchase agreements. More information about the Association and its members and activities is available on its website www.bondmarkets.com.

² See Exchange Act Rel. No. 34-53562 (March 29, 2006), 71 FR 16849 (April 4, 2006).

³ See Exchange Act Rel. No. 34-51999.

duplicative trade reporting requirements and to conflicting claims as to ownership of market data. The Association also expressed concern as to the potential doubling of regulatory fees.

In its own comment letter, dated September 7, 2005, on ABS (the "NASD ABS Comment Letter"), the NASD asserted its ultimate authority over trading on ABS because ABS would technically be an over-the-counter ("OTC") facility as to which the NASD asserted that it should have authority; in the NASD's view, the NASD was mandated to regulate the OTC market by Section 15A of the Exchange Act of 1934, as amended. In contrast to its position in the NASD ABS Comment Letter, in the Proposal, the NASD asserts jurisdiction over prices of trades that take place on exchanges. This raises the question of how the NASD and the NYSE or other exchanges view the relative lines of jurisdiction between them, and whether these lines have been established. If these lines of jurisdiction have not been established between the SROs, whether in the case of ABS or other exchange trading systems, we believe that it would not be prudent to approve the Proposal and create needless regulatory duplication.

I. Desire for Regulatory Rationalization

The Association believes that a rationalization of the SRO system is beneficial to the market. In connection with the NYSE merger, the Association, in conjunction with the Securities Industry Association, wrote a comment letter, dated February 2, 2006, supporting regulatory consolidation and highlighting the expenses imposed on the market by regulatory duplication. Attachment B to that letter set out a number of goals and principles that the Association believes should be fundamental to the SRO system. The goals include:

- Avoid duplication of examinations, investigation and market sweeps.
- Encourage specialized knowledge in regulator.
- Self-regulation should be structured so that the responsibilities of each regulator are clear and separate.
- There should be no gaps in regulatory coverage.

II. Questions as to Expanded NASD Authority

Historically, the NASD's authority under Rule 2440 has been limited to transactions in the OTC market. Each of the exchanges has had oversight authority over the pricing of transactions on that exchange. Under the Proposal, the NASD's authority under Rule 2440 would be expanded to cover exchange transactions.

As noted above, in the NASD ABS Comment Letter, the NASD itself asserted its authority over ABS based upon its "statutorily mandated oversight [role] as the OTC

market regulator under Section 15A of the Exchange Act.” This description is consistent with Section 15A(b)(11) of the Exchange Act which gives the SRO authority to make rules governing quotations “relating to securities sold **otherwise** than on a national securities exchange.” (Emphasis applied.)

In light of the Association’s desire for regulatory rationalization, the Association believes that the following questions should be answered with respect to the NASD’s Proposal to expand its authority:

- Is there a regulatory gap that is not being filled that the Proposal is intended to address? If so, why should it be filled by the NASD and not by the relevant exchange?
- Will the NASD Proposal result in both the NASD and each of the exchanges having overlapping authority with respect to transactions on the exchange? If it will not, where are the lines of authority drawn? If it will, what is the benefit provided by the overlap?
- Does the NASD have specialized knowledge as to exchange trading that would make it better qualified to regulate transactions on an exchange than the exchange itself?
- If there will be overlapping authority, are there situations in which the NASD and the exchange might come to different views as to appropriate pricing of an exchange transaction? If that is the case, can it be avoided? Will the NASD or the exchange serve as the ultimate arbiter of the trades on the exchange?
- What are the limits of the NASD’s authority under Section 15A to regulate exchange transactions?
- How will the costs of the NASD regulation of exchange transactions be allocated, including as to non-NASD member firms? Will NASD members’ costs be increased disproportionately?

III. Increased Regulatory Fees

The Association is further concerned that, in addition to the potential for regulatory duplication generated by the Proposal, the Proposal could also be used to justify an increase in NASD regulatory fees for broker-dealers. That is, the Association is concerned that the regulatory duplication will result in increased fees by the NASD due to increased surveillance of exchange transactions by the NASD. The Commission should consider the benefits to investors to be provided by the Proposal versus the

additional costs that broker-dealers will incur and unclear benefits to be obtained through this expansion of NASD authority under Rule 2440.

IV. Further Explication of the Proposal

As noted in the Proposal, NASD Rule 2440 is largely based on a study that the NASD conducted of the OTC market in the 1940s. We agree that the principles embodied in the 1940s study and resulting rule adoption remain valid. However, the Association questions whether a sixty-year-old study of the OTC market is justification for the NASD to regulate automated exchange markets. More significantly, the NASD does not explain how it would apply Rule 2440 to an exchange market. Accordingly, the Association believes that it would be preferable for the NASD to clarify how it intends to apply Rule 2440 if expanding its jurisdiction under the Rule.

V. Alternative Approach

Rather than the NASD assert its jurisdiction over exchange trading, the Association believes that the NASD and the exchanges could reach an agreement over which of them should regulate trading on the exchange. SROs normally address overlapping regulatory requirements by entering into agreements pursuant to Section 17(d) of the Securities Exchange Act of 1934 (“Exchange Act”) and Commission Rule 17d-2 (“17d-2 Agreements”), whereby one designated SRO is responsible for examining broker-dealer compliance with duplicative regulatory requirements.⁴ As the Commission stated in approving the 17d-2 Agreement between the NASD and Nasdaq, “without [the relief provided by Section 17], the statutory obligations of each individual SRO . . . could result in . . . regulatory duplication that would add unnecessary expenses” for broker-dealers. In the event that the Commission determines that the NASD’s jurisdiction should be expanded in the manner described in the Proposal, it should require the NASD to enter into 17d-2 Agreements with the various exchanges to minimize duplicative regulations.

VI. Conclusion

The Association does not believe that the Commission should approve the NASD’s Proposal for expanded Rule 2440 jurisdiction in the absence of (i) a stated justification of the existing regulatory gap; (ii) a plan to eliminate duplicate regulation by the exchanges and the NASD; (iii) a like plan to eliminate duplicate regulatory costs; and

⁴ See Exchange Act Rel. No. 34-53628.

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(iv) a clear statement of the NASD's authority to regulate exchange transactions under Section 15A.

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The Association appreciates this opportunity to address the issues raised by the NASD's Proposal. If you have any questions concerning these comments, or would like to discuss our comments further, please feel free to contact me at 646.637.9220 or via email at mkuan@bondmarkets.com.

Sincerely,

/s/ Mary C.M. Kuan

Mary C.M. Kuan
Vice President and
Assistant General Counsel

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cc:

U.S. Securities and Exchange Commission

The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Roel C. Campos, Commissioner
The Hon. Cynthia A. Glassman, Commissioner
The Hon. Annette L. Nazareth, Commissioner
Brian Cartwright, General Counsel
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NASD

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