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Chairman Christopher Cox
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Annette L. Nazareth
Commissioner Kathleen L. Casey
U. S. Securities and Exchange Commission
Washington, DC 20549

Dear Chairman and Commissioners:

The Commission's inaction on Release 34-51998 is the latest outrage in a fourteen-year scandal of SEC neglect of the public interest and investor protection. It merits investigation by Congress and the Government Accountability Office.

It is now over one year since the SEC issued the exemption proposal for comment and since then, following an eleventh hour NASD comment letter that is without merit, nothing has happened. The NASD letter will be discussed below.

During the 14 years of efforts to exempt corporate bonds from unnecessary reporting requirements no one at the SEC has articulated an even remotely coherent reason for not approving the exemption and correcting the regulatory imbalance between bonds traded on exchanges and those traded over-the-counter. The reason for this is simple -- there isn't any reason. It has not been a question about doing what's right; it's about holding on to useless authority. The SEC refers to itself as "The Investor's Advocate". The SEC's history in this exemption effort has made a joke of that description.

ABS v. TRACE

A comparison of the New York Stock Exchange's ABS trading approach and the NASD's TRACE reporting program is, again, in order.¹

¹ ABS is the NYSE's Automated Bond System, an electronic bond order matching system primarily serving individual bond investors. It commenced operations in 1977. While consideration of the NYSE exemption proposal continued, the SEC encouraged, received application for, and approved an NASD filing for the collection and reporting of over-the-counter trade price reports in corporate bonds. The program, TRACE (Trade Reporting and Compliance Engine) was filed in 1999, approved in 2001, and commenced in 2002.

- ABS provides and disseminates actionable pre-trade quotations. TRACE does not.
- ABS trades are reported at actual trade prices. TRACE price reports include undisclosed mark-ups/mark-downs.
- ABS trades are reported real-time (instantaneously upon the trade match). TRACE reported trades are not; they are reported within a fifteen-minute window.
- ABS trades are reported in precise sequence. TRACE trade reports are not.
- ABS is an auction market which allows the public to be part of the quote. TRACE is an o-t-c dealer market and does not.
- ABS has trading rules. TRACE does not.
- ABS provides a complete and accurate surveillance audit trail. TRACE does not.²

NMS Standards

ABS is an electronic auction market and is what was described in earlier National Market System (“NMS”) discussions as a consolidated limit order book, or a hard “CLOB”. If one looks at requirements of Section 11A of the Exchange Act one will see that ABS fulfills all of those requirements while TRACE fulfills none. Nevertheless, the Division of Market Regulation, which was so supportive of a CLOB for equities, is raising NMS issues in this area – promoting further delay. Yet there are no NMS questions here, because the NASD does not operate a “market” – and it falls far short on other NMS requirements.

Let me review Securities Exchange Act Section 11A (a) (1). It states:

- a.
 1. The Congress finds that--
 - A. The securities markets are an important national asset which must be preserved and strengthened.

² It should be noted that a substantial portion of the NASD’s corporate bond surveillance effort involves the daunting and elusive task of determining compliance with its mark-up/down guidelines, as well as compliance with the fifteen-minute trade reporting window. There is no mark-up/down or timely reporting issue in trading in ABS.

- B. New data processing and communications techniques create the opportunity for more efficient and effective market operations.
- C. It is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure--
 - i. economically efficient execution of securities transactions;
 - ii. fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets;
 - iii. the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities;
 - iv. the practicability of brokers executing investors' orders in the best market; and
 - v. an opportunity, consistent with the provisions of clauses (i) and (iv) of this subparagraph, for investors' orders to be executed without the participation of a dealer.
- D. The linking of all markets for qualified securities through communication and data processing facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors' orders, and contribute to best execution of such orders.

What the current Division of Trading and Markets appears to find acceptable in corporate bond price disclosure was deemed unacceptable by the Division of thirty-plus years ago in connection with the disclosure of equity prices for the developing consolidated tape for trade reporting and the consolidated quote systems. At that time, the Division of Market Regulation specifically ruled out the reporting of equity trades at prices which included mark-ups and mark-downs. At that time, the appellation The Investor's Advocate fit the SEC.

Investor Savings

A recently SEC cited 2005 study by Bessembinder, Maxwell and Venkataraman, noted that the authors found that after the initiation of TRACE reporting, large sophisticated investors found a 50% reduction in trade execution costs. That's very nice, but how much greater would the reduction in costs have been had the exemption been granted fourteen years ago – especially to individual investors, whose transactions account for two-thirds of TRACE-reported trades and who have been relegated to paying high undisclosed mark-ups and mark-downs of bond dealers. How can anyone fairly measure savings to investors in a situation

in which competition from a superior market and disclosure mechanism has been suppressed for fourteen-years?

Choice

In addition to the other advantages to the bond investing public, there is that of greater investor choice. With TRACE, investors are essentially limited to the choice of what a bond dealer has in inventory. Those choices may or may not meet the investor's criteria. After approval of the proposed exemption that choice will expand to some 5,000 corporate bond issues, with many more meeting the investor's criteria. In addition, when selling a bond, individual investors are currently limited to a dealer's take it or leave it bid – no need to mention the undisclosed mark-down. On ABS, individuals can offer their bonds at the "actual" prices they are willing to accept. When individual investors' orders match in ABS there are greater public savings – no undisclosed high charges – and no double counting inherent in a purely dealer market.

NASD Letter

This matter is now in the hands of the SEC's Division of Market Regulation. The Division, following the NASD's August 15, 2005 letter raising the so-called issue of "double-reporting", has used that issue as a hook to continue delaying the exemption and preserve its parental feeling towards the NASD's TRACE.

Double reporting may have a catchy ring to it, but in this context, it is an utterly phony issue. There are two types of double reporting; the significant one exists in TRACE itself. Double reporting exists in TRACE because almost all trades of individual bond investors must go through dealers to go from "ultimate" buyer to "ultimate" seller. According to the NASD, some 65% of TRACE-reported trades are what are categorized as individual retail bond trades (under \$100,000 par). Since there is no opportunity for these buyers and sellers to trade directly they must go through dealers at prices that include mark-ups and mark-downs. These undisclosed charges are far in excess of disclosed commissions that would be paid by investors for the same trades on the NYSE. That the SEC has allowed this, when it knows better – or should know better -- is disturbing.

The NASD's assertion that "[a] defining hallmark of a registered national securities exchange is that its members may *only* trade on it those securities that are Exchange Act registered." (Emphasis added.) That is untrue. The NYSE has long traded securities that are not Exchange Act registered, including Fannie Mae, Freddie Mac, Sallie Mae, TVA, the World Bank and U.S. Treasuries. Debt securities of these issuers trade in the NYSE's Automated Bond System ("ABS").

In addition, NYSE Rule 86, approved by the SEC, states in paragraph (c) "[t]ransactions effected through ABS are Exchange Contracts, and bids and

offers displayed through ABS shall be deemed to be bids and offers made on the Floor,". There is no mention that this provision is limited to transactions in securities registered under the Exchange Act.

The NYSE was in the bond business before the NASD was born, and ABS was developed long before TRACE became an acronym. ABS is a facility of the NYSE, a registered national securities exchange. It is not "similar" to the bond trading platforms and other OTC platforms, noted in the NASD letter.

The NYSE is a self-regulatory organization ("SRO") and, as such, it is perfectly capable of conducting its own surveillance and regulatory programs. In addition, the NASD might be reminded of the existence of the Inter-market Surveillance Group for surveillance coordination among SROs.

The NASD letter states that "[b]y seeking an exemption from a fundamental Exchange Act requirement, the NYSE Proposal is seeking to establish an NYSE execution facility in the OTC market." (Emphasis added.) What is "the" OTC market? I thought the NASD did not operate a market. Nasdaq does not operate an OTC bond market – in fact, earlier this year, the Commission approved Nasdaq's application to be registered as a national securities exchange. Where is this "OTC bond market" in which the NYSE is "seeking to establish an ... execution facility"? The NASD is trying to have it both ways. It should also be noted that the NASD, as the NYSE and SEC, has an investor protection responsibility. All corporate bonds eligible for the proposed exemption must be subject to Exchange Act financial reporting requirements. The same cannot be said for all corporate bonds reported to TRACE. Indeed, the NASD'S TRACE does not require disclosure necessary for investors to learn which bonds are subject to financial reporting and which are not.³ Nor, as noted in my letter of May 5, 2006, does the NASD acknowledge bond redemptions and reflect such information in its inferior disclosure mechanism. When an ABS traded bond is called, trading is halted until the information about the redemption is reflected in the trading of a bond being called. This permits the bond to trade on an accurate basis. The NASD does not do this, thus keeping bond investors uninformed. The NASD is therefore not in a position to preach about Exchange Act requirements.

As for the reference to the SEC "acknowledging significant concern with inter-market competition", I thought inter-market competition was a good thing. In this case why should the SEC be acting to suppress that competition by delaying the exemption, while allowing an inferior disclosure mechanism to develop: a disclosure system that the SEC, in the 1970s, would not accept in the equities

³ In 1994, the Commission solicited comment (Release 34-34922) on extending reporting requirements to issuers of debt securities, traded OTC, not subject to Exchange Act reporting requirements. At the November 1, 1994 open Commission meeting on this release, the then Director of the Division of Corporation Finance, in response to a question from the Commission, said that they expect to address this matter in the "not too distant future". That was, and has remained, the Commission's last word on the subject.

markets. Also, since the NASD stated that they are "neither a market operator nor a trading center," how does this apply to them? What are they worried about?

The NASD's inability to see the full picture exists solely in TRACE. They are "regulating" a very fragmented market with trades being reported with marked-up and marked-down prices, out of strict time sequence, thus creating a very blurred picture that, without ABS-type pre-trade quotes, is also an incomplete picture.

Nasdaq, a company affiliated with the NASD, in its July 2, 2004 comment letter on proposed Regulation NMS, questioned the need for consolidated last sale reporting, stating, "the consolidated last sale is not essential to investors and should not be included in the Plans. In its current form, consolidated last sale reporting is far less useful than the NBBO... ." (National Best Bid or Offer). The letter goes on to note the "numerous data quality problems" with the trade data disseminated under the current plans: trades not reported or displayed in strict sequence, and the lack of uniform trade reporting rules across markets... ."

The NASD cannot apply this Nasdaq approach to TRACE and ABS. The sequencing problem, with TRACE's 15-minute reporting window, exists "within" TRACE itself—they have no NBBO fall-back argument. The problems are compounded with TRACE price reports including mark-ups and mark-downs v. ABS's actual trade prices. The Nasdaq NMS letter goes on to state (p. 28), "[d] *e-consolidating* last sale data and subjecting individual SRO's last sale data to competition would increase the quality of that output and its value to investors." (Emphasis added.)

The "incomplete" and "inconsistent" information the NASD refers to is TRACE's, i.e., no quotes, or quotes that vary, depending on who the customer is and, in any case, do not have to be honored. Also, there is no way for investors, particularly individual investors, to determine (a) the price paid (received) for the bonds and (b) the compensation paid for the service. Mandating the consolidation of this bond data, as the NASD proposes, would do nothing to remedy these shortcomings. Data consolidation can be accomplished by market data vendors without mandates and, one such vendor has been doing exactly that for several years. The problem is that as the SEC has delayed this initiative for fourteen years, the public has become the poorer and NYSE bond volume has steadily declined as its inventory of bonds has declined.

The Division of Market Regulation may have fallen for this NASD nonsense, but the Commission should not. The SEC has voted to require issuers to be more forthcoming about executive compensation, yet it remains protective about

hidden bond dealer undisclosed mark-ups/mark-downs. By adopting the exemption described in Release 34-51998, the SEC will add meaning to its claim to be The Investor's Advocate.

I will pleased to answer any questions the Commission may have on this and related matters.

Yours truly,
Fred Siesel⁴

⁴ For fourteen years I was closely involved with this NYSE exemption effort, first as an Exchange employee and for the last four years, until the end of 2005, as a consultant. During most of the 1970s I worked for Weeden & Company and was actively involved with market structure issues being addressed by the Congress and the SEC, including unfixed commission rates, the consolidated tape and quotation systems, barriers to competition, and the enactment of the Securities Acts Amendments of 1975. During most of the 1960s I worked for the SEC in Washington, DC, the first two years for the Special Study of Securities Markets and then for six years with what was then the Division of Trading and Markets.